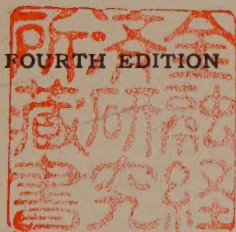


財團金融經濟研究所
法人藏書

FINANCING AN ENTERPRISE

A Manual of Information and Suggestion
for Promoters, Investors, and
Business Men Generally

BY
FRANCIS COOPER



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PREFACE

The principles of finance do not change, but their application does. Also, illustrations fall behind and must be replaced. For this reason, the author has taken advantage of the present opportunity to make such changes as will adapt the book to present conditions.

As to the purpose of the present work, the author cannot express it better than in the following quotation from the preface of the first edition:

“Speaking generally it should be possible to finance any good enterprise. As a matter of fact numerous enterprises are financed that cannot be designated good. Still further, many enterprises are financed that are not only bad but absolutely fraudulent. Failures to finance enterprises are, however, frequent, even when the enterprises have real merit and the general conditions are favorable. Such failures can only be ascribed to a disregard or ignorance of the principles and procedure of successful financing. The object of the present work is to set forth these principles as clearly as may be, to point out the common mistakes, to suggest the best methods of procedure and to serve generally as a manual of information.

“The scope of the work extends beyond the direct financing of an enterprise, including its investigation, valuation, preparation and presentation, and its protection meanwhile; also a discussion of the somewhat difficult matter of capitalization, with suggestions as

to the use and adaptation of the corporate form, and a consideration of promoters, of the various devices used in promotion, and of other related matters.

"Also, as the effective presentation and successful financing of an enterprise are not usually possible unless the point of view—often widely divergent—of both the man with the enterprise and the man with the money are known and given due weight, the present volume treats its subject as far as possible from the standpoint of both parties.

"It may be said that the statements, comments and suggestions of the present volume are based on an experience of some fifteen years in legal work connected more or less directly with the financing of enterprises. The author can only hope that these gleanings from experience will be helpful to those into whose hands the volume may come, and save some of his readers at least from the expensive and often disastrous mistakes so common when enterprises are to be financed."

It may also be said that the general purpose of the book is to assist in honest promotion. It has no sympathy and nothing in common with the get-rich-quick artist, or with those who seek to unload worthless, or over-capitalized offerings on unwary or ignorant investors.

The author takes pleasure in expressing his very sincere appreciation of the friendly reception accorded the preceding editions of his book. Its sale, extending to every civilized country of the world, is a practical tribute to its worth that cannot be but gratifying to the author.

FRANCIS COOPER.

New York City,
March 1, 1915.

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FINANCING AN ENTERPRISE.

PART I.—THE ENTERPRISE.

CHAPTER I.

INTRODUCTORY.

An enterprise, as contemplated by the present work, is any undertaking that may be financed. It may be an invention, a mine, a business, a combination, a consolidation, or any other form of commercial activity. It may be a development proposition, it may be a going concern, or it may be something merely demanding liquidation. If there is a proposition on one side, seeking money for its purposes from the other side, it is an enterprise as here considered.

As to what enterprises can be financed, it may be said broadly that money may be raised for anything capable of being utilized for purposes of profit, or which men with money may be led to think can be so utilized. The nature of the enterprise—ethical considerations apart—is of minor importance, its successful financing whether for its own operations or for the

benefit of its promoters, being mainly a matter of preparation and presentation. In the author's recent knowledge, an invention, untried, unpatented, and existing mainly on paper, secured financial support in cash to the extent of nearly \$40,000. Further, a large portion of this amount was placed in the inventor's hands without restriction of any kind, and all this was done solely on the unsupported statements of this same inventor as to the value and conditions of his invention. In this case the man presenting the enterprise honestly believed the statements he made, but this belief, as shown by results, was purely a matter of faith—not of works.

Nor is this an exceptional case. It is a matter of common observation that investors will, if properly encouraged thereto, lend their financial assistance just as freely and even more cheerfully to some impossible scheme for the extraction of gold from the waters of the sea, or to the development of some remote or even non-existent mine, as to the establishment of some solid industry in their midst.

It is true that the promotion of illusive schemes such as those referred to, sometimes brings the promoter's career to an abrupt termination in the penitentiary, and for this and other reasons should be deprecated. The methods adopted in the presentation of such swindling enterprises, however, evince much knowledge of human nature, are often good, and should be noted and applied, as far as may properly be done, in the promotion of honest undertakings. "Beauty unadorned" is not usually appreciated in the

presentment of an enterprise. A bald statement of the facts without comment or elaboration may, if the facts are sufficiently good and the men behind the enterprise are financially strong, be effective and the best presentation that could be made. Usually, however, an enterprise so presented gets no further than its presentation. Something more attractive is needed if it is to be financed.

Just how far verbal gilding may be carried in promotion without overstepping the bounds between legitimate statement and false representation, is perhaps open to debate.* There is, however, no question that an enterprise to be financed may be made or marred by the manner and conditions of its presentation.

*See Chapter XXIV.

CHAPTER II.

CONDITIONS OF FINANCING.

To the inexperienced, the financing of an enterprise does not seem difficult. Indeed to those unfamiliar with the state of the "industry," it appears quite as difficult to secure a good enterprise as to secure the funds for its flotation. There is money a-plenty in the world for all that is to be done. It cannot be left idle; it must go into something, and therefore, if one has a meritorious enterprise it should not be more difficult to sell an interest in it than to sell any other possession of material value. That this is not an uncommon impression is shown by the constant enquiry, in entire good faith, for reliable houses engaged in the work of financing enterprises—concerns through which the man with a good undertaking may finance his enterprise just as he would rent a house through a real estate agent, or sell his crops through a commission merchant.

Theoretically this should be so. Practically it is not. As a matter of fact, enterprises, even though good, are ordinarily floated with difficulty, and while houses undoubtedly do exist for the announced purpose of financing enterprises, they are, as a rule, far more active and successful in securing money from their clients than for them.

For this failure of theory, the very unfortunate conditions under which enterprises are usually presented must be held responsible. That this is true is shown by the ease with which an enterprise is financed when the conditions are favorable. Thus a successful business man of proved integrity takes up some new enterprise, looks into it carefully and then with a sound and well-matured plan of operation, invests his own money in it and invites his business associates to do the same. If the enterprise is suitable and the time is right, he will dispose of this offered interest with ease—much more readily than he could negotiate the sale of his house or find a purchaser for a surplus stock of goods.

It is comparatively seldom, however, that such conditions obtain. Successful business men, as a rule, are very fully occupied with their own pursuits. They are not neglecting their regular avocations for the discovery of new lines of industry, nor are they devoting restless nights to the invention of novel mechanisms. They are already profitably busy and usually only take up such enterprises as come to them incidentally or in the course of business.

For this reason perhaps a majority of the enterprises brought forward are in the hands of young or inexperienced men, overly enthusiastic and sadly lacking in judgment; of inventors, often mentally loose-jointed and widely impracticable; of unsuccessful business men warped by their reverses and snatching at straws; of adventurers without money or reputation and anxious

only to turn a penny without regard to the means employed.

Add to this the further facts that men are too frequently but "indifferent honest" and, speaking generally, too anxious for the success of their particular undertakings to be overly exact in their representations; that too often their offerings are doubtful, defective or even impossible undertakings, "touched up" to appear as golden opportunities; that their terms are apt to be as remarkable as their offerings, not uncommonly requiring that the proposed capitalistic victim shall put in all of the necessary funds, take a small interest in return and leave to the promoters the control of both enterprise and money,—take all this into consideration, and the hesitation of the man with money even to investigate, much less embark in "unaccredited" enterprises, may be readily understood.

All this misrepresentation, chicanery and extravagance of statement and demand, reacts to the very great injury and disadvantage of legitimate propositions. It explains much of the difficulty of financing and should be very clearly understood by the man who has an enterprise to present. It also partially explains the suspicions, exactions and often most unreasonable demands of the men with money.

Indeed, it may be said in defense of the capitalist, that while he very frequently does take advantage of the ignorant, the unsuspecting or necessitous inventor or owner, he is at least as much sinned against as sinning, and that for every man with an enterprise who has been hardly treated or "frozen out" by his

financial backers, it would be possible to discover a hundred men with money who have been drawn into unprofitable or impossible undertakings by misrepresentation or by even more flagrant fraud.

To turn from the standpoint of the promoter to that of the investor, it may be said that the profitable investment of money is usually a matter of real and serious difficulty. In the East, savings banks offer from 3% to 4%; first-class city real estate mortgages pay from 4% to 5%; the usual good bonds and gilt-edged stocks about the same; Government bonds considerably less. All these are reasonably safe but are not large revenue bringers.

If better rates are desired, not only must a certain added risk be taken, but even with this drawback good investments are not abundant. Established enterprises, as a rule, offer but little more for money than the prevailing interest rates. If, then, a materially larger rate of profit is desired, investment in some undeveloped or speculative enterprise is usually the only resource. For this reason, if a man has money to invest, he is rarely so occupied, so indifferent, or so difficult of access, that the right kind of enterprise, properly presented, will not command his attention. Whether it will secure his money depends upon the ability of its presentation and the strength of its attraction for him.

Opportunities for more or less speculative investments are offered him in abundance, but the majority of these are as risky as they are—according to the statements of their promoters—profitable. Under

these circumstances, if the man with a really good enterprise and a fair proposition can get at people with money and convince them that his enterprise is good, that—if the enterprise is to be under his control—he is capable of its successful management, that his standing and integrity are such as to justify their trust, and that the returns to be reasonably expected are sufficient to justify the business risk involved, he will have no trouble in securing all the money required.

Of all these requisites a reputation for success and for honesty is perhaps the most important. The majority of investors cannot take the time or go to the trouble and expense of making a proper investigation of an offered enterprise, even were they capable of doing so. Neither are they able, after investment, to supervise their interests so closely as to protect themselves properly against either dishonest or inefficient management. This being true, the average man and woman would rather entrust their investments to one in whose honesty and ability they have confidence, merely on the strength of his statements, than to a stranger, or to a man of doubtful integrity or unknown ability, even after the most searching investigation of which they are capable.

It must be confessed that there are numerous startling and most remarkable exceptions to this general rule—cases where men give up the savings of years to persuasive strangers of whom they never heard before and of whom very frequently they never hear after; gold bricks are purchased freely not only in the

rural neighborhoods, but right in the city of New York; extravagant and widely advertised enterprises continue to reap opulent returns from subscribers, if not from dividends; the Keely motor is not yet forgotten by its confiding supporters, and the enumeration might be continued indefinitely and most unprofitably.

These things are, however, abnormal. They are the "sports" of the financial world, and, while they are not uncommon, the ordinary man can hardly expect, and the honest man would not wish, to profit by anything of the kind. On the contrary, and especially when engaged in promoting, honesty, properly fortified by ability and a knowledge of business procedure, must still continue to be the best policy, and it is on the uninflated and solid basis of good reputation and fair representations that the best financing is and must be done.

In conclusion it may be said that the ideal conditions for the financing of an enterprise involve a good proposition, well presented at the right time to people who have money to invest, by a man who commands their business and personal confidence. Under such conditions the financing of an enterprise is easy. The more widely these conditions are departed from, in whole or in part, the more difficult the matter becomes. The great secret of successful financing is then to approximate these ideal conditions—in fact or in appearance—as closely as the actual conditions will permit.

CHAPTER III.

METHODS OF FINANCING.

The usual method of financing an enterprise, and the one discussed at length in the present volume, is that of interesting moneyed men. Other methods are, however, followed on occasion. The simplest of these is found when the owner or promoter has the means, and himself invests the money needed for his enterprise. Much difficulty is avoided by the adoption of this plan, but unfortunately it is not generally practicable.

Next to this method comes the good old plan of gradual development—the actual building up of the enterprise from the financial materials at hand, these materials being at first perhaps the accumulated means of the parties, then returns from the operations of the enterprise itself, or funds secured from some other occupation or business while the enterprise is in course of building, or a combination of any two or all of these.

This method is absolutely inapplicable to the development of those very numerous enterprises where large purchases, investments or installations are an essential preliminary. There are other cases in which it is entirely inadvisable because of the slowness of the process, as in the development of a patent with but a

limited period to run, the building up of a business where competition may only be overcome or prevented by quick and brilliant success, and the many other cases where time is the "essence" of the undertaking.

Where this development plan is applicable and advisable, it is ideal. It avoids the risks, the mistakes, the expensive experiments, and the premature development more or less characteristic of all "financed" enterprises in which the managers are inexperienced or the lines of business new.

It is the step by step method. A man developing an enterprise in this way is, at the start, working on a small scale, his expenditures are necessarily limited and his progress is unavoidably slow. His experiments are, as a matter of necessity, cautious, carefully watched, small in cost and quick in results, be they good or bad. If good, the particular line of effort is pushed; if bad, abandoned without serious loss of either time or money. In either case the facts of the particular experiment are determined in the course, perhaps, of a few weeks and at the cost of a few dollars, while in a more pretentious venture the same results would be demonstrated no more satisfactorily at a cost of hundreds or even thousands of dollars and months of time.

During this period the proprietor is going through a course of business training, from which he secures a grasp of the business, and an understanding and control of its every feature that nothing else could give so thoroughly and satisfactorily. As a result of this he frequently attains a degree of success which

would hardly be possible under any other system of development. He grows into prosperity and when he reaches it he is so firmly rooted and grounded at every point that he fears neither competitors nor the severest industrial storms.

This method of developing an enterprise may be said to be the primitive and natural method. Examples of its successful application are, from the time of Dick Whittington and his cat, and before, numerous and well known, and are the basis for many an instructive discourse of more or less dubious soundness.

A striking and pleasant illustration of this method of developing an enterprise, is found in the Mary Elizabeth Candy shops. But little more than ten years ago, Mary Elizabeth Evans, a girl of sixteen, her widowed mother and three younger children, were living on their grandfather's farm near Syracuse, New York. The death of their grandfather had thrown them on their own resources, and the problem of money for clothes, education, and the many other requirements of a growing family, was very difficult. The task of solving the problem devolved on Mary Elizabeth.

To meet this situation, Mary Elizabeth possessed two especially valuable personal qualifications, neither as yet recognized by her as a business asset. She was a born candy-maker and a born executive. In addition, she was desperately anxious to increase the family income. But what to do, she did not know. Her attitude was one of "watchful waiting."

Her opportunity—though not recognized as such

at the time—came in the form of a house-party given by an old family friend in Syracuse. Mary Elizabeth wanted to help, and her contribution to the pleasures of the gathering was a box of home-made candy, sent in a neat box and labelled with the now familiar legend, "Mary Elizabeth's Candy." The candy made a "hit." It was good, it was attractive, it was different from anything the guests had tasted before, and inquiries soon drew from the willing hostess its story, together with an opinion that orders would be gladly received. The guests were interested and practically every one of them put in an order for a weekly box of Mary Elizabeth's candy.

This was the starting-point of the Mary Elizabeth business. The candy was made at home and delivered by the children, collections being made as the candy was delivered. The little trade thus established grew, but grew slowly because of the difficulty of making "connection." Possible patrons could not be expected to employ a detective to ferret out the source of supply. Or, even if they knew where the candy came from, it was difficult for them to place orders and Mary Elizabeth soon saw that some more effective method of selling and distributing was essential if the business was really to amount to anything.

At this critical time it was suggested to Mary Elizabeth that a booth could be rented on easy terms in the Arcade of the University Building. This would give a central and desirable location in Syracuse. The rental was within reach and the opening attractive, but how was attendance to be provided for?

Mary Elizabeth herself, had the candy-making to look after; the other children were too young; a paid attendant was beyond their means. An implicit trust in human nature finally solved the problem. *The customers must serve themselves.*

The booth was rented, neatly fitted up, and stocked with an attractive display of candy, every box plainly labelled with its price. An open cash-box was provided and suitable signs notified the passers-by to help themselves, and put the money in the box. Change to the amount of two dollars was placed in the cash box for the convenience of customers and the new venture was launched.

The success of the "help yourself" booth was immediate. The excellence of the candy, the attractiveness of the display, the entire novelty of its method, brought a liberal and increasing patronage. The contents of the cash-box sometimes ran up as high as fifteen dollars. Customers, neighboring tenants and even the newsboys who sold papers in the Arcade, vied with one another in the protection of Mary Elizabeth's property, and the promotion of her business.

The success of the booth soon supplied the funds and the basis for a larger and more convenient candy shop located near the Arcade. This store, conducted on the same principle of giving value received, always meeting the demands of its patrons, of being a little different from other stores, was as successful on a larger scale as the booth had been; and from that time on the Mary Elizabeth record is one of a successful and self-financing undertaking.

At the present time, the Mary Elizabeth business is a large one. Its candy stores and tea rooms are located in half a dozen different cities. The rental for one of these alone—the Fifth Avenue store in New York City—amounts to \$45,000 a year, and the annual “turn-over” of the various establishments runs far up in the hundreds of thousands of dollars. Mary Elizabeth is still at the head of the establishment. It is still conducted on the same general lines laid down in the early history of the undertaking.

By way of contrast, another instance known to the writer, but not to fame, may be cited. Some years before Mary Elizabeth made her start, a gentleman skilled in food preparations, discovered a new and attractive preparation of chocolate—a soluble chocolate, different from anything else on the market, convenient for use and as good a foundation for a profitable business as could be wished.

The inventor, through illness and attendant business reverses, was unable to put any considerable sum of money into the development of his invention, and the question as to how it should be handled was an important one.

As will be seen the enterprise thus opened up was one that lent itself admirably to the personal development plan. The few hundred dollars necessary for a modest start could have been provided by the owner himself; the expenses could have been met by the returns from the business; it would have been readily self-sustaining as it grew, and the presumption is a fair one that had the owner followed the method

of self-development, he would now be the fortunate possessor of an unusually large and prosperous business.

The inventor, however, instead of following the lines of personal development, concluded that the enterprise was too good to require a term of years for its upbuilding and that it could and should be financed by some speedier and easier method. After due deliberation, he decided that \$100,000 was needed to put the preparation properly on the market and capitalized the enterprise on this basis. Then, instead of putting in his time, energy and money as before to building up the business, he devoted himself to a campaign for development money.

The results were most unfortunate. Begun nearly fifteen years ago, this campaign has continued up to the present, and the end is not yet. The time has been lost, the enterprise and its owner have been harassed by a steadily growing indebtedness, other similar preparations have appeared on the market, and the inventor is now apparently no nearer the realization of his hopes than he was at the beginning.

It is but fair to say, however, that in this case the inventor lost several good opportunities of financing his undertaking, through the unreasonable nature of his demands; also, that had he made a fair proposition for the needed capital and secured it, as he could have done, the business might have reached substantial success in a very much shorter period than would have been possible under the slow process of personal development, and that this quicker success would

probably have preserved to it a monopoly that is now impossible.

A modification of the personal development method sometimes followed with excellent results, is the gradual upbuilding of a new enterprise as a side line. That is, the owner, already occupied, continues in the business or employment in which he is engaged and from which he derives at least a support, and gives the new venture such time, attention and money as it needs or as he can spare from his main work.

It is obvious that this method is of very limited application. The conditions that permit it are unusual. As a rule, success in any enterprise, and more particularly a new enterprise, requires the closest and most unremitting personal attention. There are, however, undoubtedly enterprises that can be worked up by this method, or by modifications of the method, and at times it may be used to great advantage.

The plan is sometimes adopted with good results where two parties are interested in an enterprise, the one taking charge of the new enterprise and the other retaining his regular employment as a base of support, this latter giving to the new business such financial aid and personal attention as he may find possible. Then when the new enterprise is brought to the point of self-support, the "sustaining" associate withdraws from his regular occupation and gives his entire time and attention to the new undertaking.

Occasionally this plan is modified, the owner employing some one to take charge of the new enterprise while he continues his own regular work, merely

supervising and assisting in the new undertaking as he may be able, until some better arrangement is possible. The chief obstacle in the way of this method lies in the difficulty of securing an employee of sufficient honesty and ability to take charge of the new business.

The advantages of this "side line" financing, when it is practicable, are obvious. In a new enterprise of limited capital there is almost invariably a period of harassing uncertainty, sometimes quite prolonged, when the income is exceeded by the outgo and the future of the whole venture trembles in the balance. If then, the owner is meanwhile profitably employed and able to supply additional funds as they are needed, the danger of failure is largely removed and the very knowledge that the "base of supplies" is not in danger is in itself an element of strength and of success.

On the other hand, the development of a new enterprise by this method is slow, the business itself is almost certain to suffer and perhaps fail from lack of attention, and, finally, it may be said that in practice most of these side line attempts are failures.

Another method of financing enterprises sometimes employed is to borrow the money required. This is only possible where the personal standing or the collateral security of the borrower is such in itself as to justify the loan, as it is seldom that the enterprise itself would be considered security for the money needed for its development.

If the enterprise itself is good, the owner or the party in charge a good manager, and a loan can be

made on fair terms, the plan has advantages, mainly in the fact that the control and ownership of the new undertaking are left in the hands of the original parties. It is true that a bonus must often be paid to secure the money; that interest must be paid on the loan, and that the borrowed money must, sooner or later, be returned. If the enterprise is successful, however, the indebtedness and interest payments are easily carried and paid off in due time, and the whole amount given for the use of the money should be small compared with the profits of the enterprise or compared with the interest in the enterprise that must have been given to secure the needed money as an investment.

If, on the other hand, an enterprise ends in failure, the loaning plan is disastrous—far more so than if the money were secured as an investment in the enterprise. For this reason many people, well able to borrow, prefer to get part or all of the necessary money as an investment in the enterprise rather than as a loan. In this case they divide up the risk. They do not look for failure, but they recognize its possibility in any undertaking, no matter how good. Therefore they prefer to diminish their own interest in the enterprise and in the profits to be made, rather than to take chances of a total and perhaps disastrous loss in case of failure.

Also while the interest on the money borrowed is, in the case of a good enterprise, negligible, there are other dangers connected with the method. Loans and interest payments have a tendency to become due at inconvenient times, or if left to run after they become

due, may be called unexpectedly. Then if not met, they may be used to the serious embarrassment of the enterprise.

As a matter of fact loans are not infrequently made to parties having promising enterprises, with the definite hope or expectation that they will not be able to pay the amount when due. In such case the parties making the loan promptly foreclose and buy in the enterprise at a tithe of its real value. To secure properties by foreclosure in this way is regarded by those who engage in the practice, as entirely legitimate and even clever business. The fact that it may be done and is done should always be borne in mind when loans are made, and extensions should be provided for, or time sufficient should be obtained to permit the enterprise to pay out, or perhaps provision may be made to meet the loan from other sources, if it should prove desirable.

Another method of financing, frequently practiced, is that of taking in moneyed partners. This is but a modification of the usual plan of securing money as an investment in the enterprise—usually in the form of stock subscriptions—but it has some special advantages and disadvantages of its own.

It must be borne in mind that a partner has all the rights in the business that the original owner has himself. He can interfere in the management of the enterprise, run it into debt, if he sees fit, or make trouble in the many other ways possible under the partnership arrangement.

All this is of no importance if the partner is known

to be the right kind of a man, who will shoulder his part of any burdens to be borne and who can be depended upon to co-operate when needed and to do nothing when not needed. If, however, there is any doubt as to the character or disposition of the prospective partner, this close alliance should be avoided—preferably, and as is commonly done, by the use of the corporate form.

Another point to be considered when a financing partner is taken into an enterprise, is the fact that should the enterprise not reach the point of profit paying before its funds are exhausted—a contingency that frequently occurs—the conditions are not favorable for securing further money.

In a corporation, stock may be reserved for just such emergencies, or a special issue of preferred stock or perhaps bonds can be arranged. In a partnership, on the contrary, there is usually no reserve of any kind that can be offered for additional money. If more money is needed each partner should, of course, contribute pro rata of his interest for the purpose, but in practice it not uncommonly happens that the “financing” partner refuses to do this.

Sometimes the moneyed partner refuses because he thinks the management of the business has been poor and that therefore the “working” partner, who is responsible for this, should bear the burden of securing additional funds. At other times, he declines from purely selfish reasons, thinking that the working partner’s interests are sufficiently large to force him to pull the enterprise out somehow unaided. On rare

occasions help is refused because the financing partner hopes that the embarrassment of the business will result in conditions which can be made to serve his own interests, possibly resulting in his acquisition of the whole enterprise.

In any such case, the working partner must do the best he can. He may be able to borrow, or he may have to make very material sacrifices of his own interests to obtain the needed funds. In such case, if the enterprise is successful, he will probably be able to recoup himself. It is, however, far better that the possible need of more funds should be anticipated and provided for in advance by some provision of the partnership agreement. It is better still to avoid the contingency by the incorporation of the undertaking.

The usual, and, speaking generally, the best plan of financing is by the sale of stock in the incorporated enterprise. It offers advantages both for the owner of the enterprise and the investor found in no other system of business organization. The use of the corporate system for this purpose is fully discussed in Chapter XLI of the present work.

CHAPTER IV.

REQUISITES OF A SUCCESSFUL ENTERPRISE.

For a complete industrial success three things are essential:

- (1) A sound undertaking.
- (2) Sufficient capital.
- (3) Efficient management.

If any one of these is entirely lacking, failure is reasonably sure. If any one is deficient, the difficulties of success are enormously increased. In any case the measure of success usually varies directly with the greater or less perfection in which these essentials are found.

The necessity for a sound undertaking will be readily admitted. In some cases, however, an undertaking must be developed before its soundness or unsoundness can be determined. In other cases, enterprises are founded on unsound undertakings, as a result of fraud, ignorance, recklessness or poor judgment on the part of the "man with the enterprise," usually coupled with "contributory negligence" on the part of the investor.

The number of failures due to the fact that the basic undertaking was rotten or so unsound as to be no proper support for the proposed industrial structure,

is surprising. A striking instance within the writer's knowledge still stands in a pleasant rolling district of what is now Oklahoma, where nature is not only liberal in the disposition of mineral wealth, but, to make it easily accessible, has inclined the rock strata at an angle of nearly 45° .

Here a vein of bituminous coal some two or three inches thick crops out right at the top of a grassy hill. Coal is not abundant in that portion of Oklahoma and a good vein of the material is a development proposition of much interest. The little seam therefore, rightfully enough, attracted attention. No preliminary drilling or other investigation was, however, deemed necessary. The vein was there and could be seen, and on the easy assumption that its thickness increased with depth, was taken up and liberally financed by Northern capitalists.

A complete and excellent plant was erected on the outcrop. Expensive machinery for pumping and for mining and handling coal was installed. In the near vicinity some thirty-five or forty comfortable houses were erected for the accommodation of the men, together with stores, shops, stables and the other paraphernalia of a small village. Roads were laid out around the mine; a spur from the line of railroad, some seven miles distant, was graded, rails were laid and everything necessary for the economical and convenient operation of the property was installed.

While all this was going on a substantial, well-timbered, double shaft was following down the incline of the little vein. After sinking some hundreds of

feet it was discovered that the thickness of the vein did not increase with depth and that as far as had been gone there was not enough coal in the mine to operate its own hoisting engines. Then, and not till then diamond drills were resorted to and by their means the property was shown to be utterly worthless for purposes of coal mining, and the whole enterprise, on which nearly \$100,000 had been expended, was abandoned. Practically the entire investment was lost. Worse still, the confidence of the capitalists whose money had been so ruthlessly and so foolishly sunk in this "hole in the ground" was shaken—not only as to this special failure, but as to the whole country as well. As a matter of fact, they absolutely refused to advance any further funds for enterprises in that part of the country.

In the instance cited, the disastrous results achieved might have been avoided entirely by an early and judicious use of the diamond drill. The failure to do so can only be ascribed to ignorance, to an almost criminal indifference as to the proper methods of preliminary procedure, or to fraud on the part of the original promoters. The capitalists were, however, also much to blame for not insisting on a proper investigation of the property before sinking their money in premature development.

In some cases, as has been said, the soundness of an undertaking cannot be determined in advance, the only practical test being a more or less complete development. Thus some mechanisms cannot be properly judged until a full-sized working model has been

constructed. The results then show whether a prize or a blank has been drawn. The method is expensive, but at times no other is possible.

Generally speaking, however, the value of an enterprise may be at least approximated in advance, and when this can be done, the adoption of a radically defective undertaking for development indicates either fraud or some inability on the part of the promoter, or gross carelessness on the part of the investor, whose money is risked. Sometimes these may be combined as when—as occasionally happens—an unlucky mortal undertakes in all good faith to finance an enterprise, improbable or impossible in itself, but in which from lack of judgment, knowledge or investigation, he has entire faith. He sinks his own and his friends' money in its development and is finally threatened with ruin because of the worthlessness of the undertaking. The temptation is then strong to postpone the day of reckoning, conceal material facts, secure more money and push on in hopes that something may turn up to relieve the situation. The position is one that tends to turn an honestly mistaken man into an impostor.

It makes but little difference as to results, however, whether a defective enterprise is foisted on investors through fraud, ignorance or other disabilities of the promoter, or from their own carelessness. They are separated as effectually from their money in the one case as the other and with perhaps as little satisfaction. Therefore, as a matter of common honesty, no pains should be spared by the owner or promoter to prove the value of his enterprise as far as may be before it

is presented to the investor, and as a matter of the most ordinary precaution, the man who is to invest his money should see that this has been done, or is done before his money is involved.

The necessity for the second essential of a successful enterprise—sufficient capital—will hardly be questioned. The only point upon which a difference of opinion is likely to exist in this matter is as to the amount required. Speaking generally, there is a strong tendency to underestimate the amount necessary for any particular undertaking. One not accustomed to matters of the kind will sit down, figure out the apparent necessary expenses, add a fair percentage for incidentals and margin, and deem the matter settled. One experienced in the work knows that at every stage and step of development there are expensive delays, modifications of original plans, unexpected experimental work, additional equipment, and along with it all, endless incidental but unavoidable extras and expenses that bring the sum total far above anything that would at first sight seem possible. For this reason where the party estimating is not entirely familiar with the particular line of business, a considerable excess should be allowed on every important item for unforeseen expenses, and in addition a liberal percentage be set aside for incidentals and operating margin.

A feature of much importance to be considered in this connection is the difficulty of raising further money for an enterprise in case the original funds are exhausted before it reaches a condition of self-support.

When an enterprise is first presented, if the proposi-

tion and conditions are favorable, it is nearly always possible to raise the amount thought necessary for its purposes, and it is a measure of wise precaution to secure a treasury reserve of cash at this time sufficient to carry the company through to success. Whenever the funds provided prove to be insufficient and are exhausted before the enterprise has reached the self-sustaining point, the condition is peculiarly unfortunate. The failure to pull through is hard to explain, the enterprise is discredited, and the whole thing is looked upon as at least a "lame duck," if not a complete failure.

Under these conditions, to secure more money on any ordinary basis is almost impossible. Usually then some one person must be found, or a small syndicate be formed, to furnish the requisite money. The matter is always one of great difficulty and if it is accomplished, the "carrying" individual or syndicate usually demands, and perforce receives, payment out of all proportion to the amount of the investment. The enterprise is looked upon as fair game, and a controlling interest in the whole or even more, depending upon the necessities of the stranded undertaking, is not considered unreasonable. It is a case where money must be had at any cost and this cost is usually fully proportioned to the urgency of the needs.

Such a situation should be avoided by a sufficient provision at the time the enterprise is launched to carry it safely through to the point to be attained. If as much as is needed cannot be obtained at that time in cash or safe subscriptions, the enterprise should

either be held back until the required amount can be secured, or the development plans be so modified that the amount in hand will suffice. To do otherwise is, as a rule, to invite disaster.

Sometimes the danger from this source is anticipated, and provision made for the raising of additional funds if needed. This is usually done by the reservation of stock. Then, in case more funds are needed this stock can be offered for sale and the whole matter is on a much better footing. The idea of failure is removed, and the whole transaction is merely one of securing additional capital, the need for which was seen and provided for in advance.

The position of the enterprise which has reached a point of self-support and moderate returns, but which must raise more capital before further progress can be made, while not exactly favorable, is still far superior to that of the stranded enterprise. It is beyond the dead line. It has life and vitality. It is neither a suppliant nor a forlorn hope. The risks of investment in it are minimized and there is a certain degree of attractiveness about it that makes the raising of additional capital very much easier. The situation is not an uncommon one and the ordinary methods of securing capital may, as a rule, be used with success.

A somewhat unique organization was formed in New York City some years since for the express purpose of financing enterprises which had reached this point of non-elastic self-support. Its terms were also unique. If it advanced funds sufficient to enable the struggling company to take advantage of the oppor-

tunities then open, or to extend the general sphere of its operations, the "carrying concern" demanded as its compensation;—first, that money advanced by it should be a lien on the whole enterprise; second, that the money advanced should be repaid as soon as it might be done without injury to the business, and third, that the company in return for the money advanced should participate for a term of years in the *increased* profits of the enterprise—usually to the extent of about 25%. The arrangement, though presenting some difficulties, both legal and operative, was not unfair, but the company has since retired from active business. The same general idea is, however, being carried out by individuals with considerable success, the terms varying with each enterprise taken up.

Of the requisites for the successful development of an enterprise, the third—efficient management—is perhaps the most important. The undertaking may be meritorious, the money supply may be more than adequate, but without good management, failure is almost assured. On the other hand, though the undertaking be indifferent and the money supply scanty, a first-class manager will overcome every difficulty. Usually the degree of success in any particular enterprise is determined very accurately by the ability of its management, and one of the most difficult problems of industrial success is solved when good management is secured.

Further, if the enterprise is yet to be financed, the employment of a manager known to be competent and

successful is a material assistance in securing funds. Apart from any confidence the investors may have in the ability of the manager to bring the enterprise to a successful issue, the mere fact of his willingness to have his name coupled with the enterprise, is a strong and weighty testimonial to its merits and probabilities of success. It is an incidental endorsement of more moment to the average investor than the favorable reports of half a dozen technical experts.

It might also be noted by those with enterprises to finance, that the successful manager is almost invariably a person of some means as well as ability, and that where the enterprise is such as to enlist his entire confidence, he is usually quite willing to take an interest therein on proper terms beyond his "per diem." Where this is the case the endorsement is doubly strong, and the parties controlling the enterprise are justified from every point of view in making all reasonable concessions to secure the subscription of the future manager. Such a subscription is not only an addition to the financial strength of the enterprise and a potent argument for other subscriptions, but also amounts to a hostage from the manager for the faithful performance of his duties and for his loyal and unswerving support of the undertaking.

To secure a good manager is not usually an easy matter. Enterprises are always looking for capital; capital, even when most busily occupied, always keeps a wary eye on the industrial field for anything a little extra good in the way of enterprises, but the good manager is constantly employed and is not looking

round for new openings. He usually is not averse to a proposition that will better his condition, but he is not waiting "in the open" for anything of the kind and must be sought if he is to be found.

The difficulties of securing good management are occasionally much complicated by the number of "self-confessed" experts who obstruct the industrial ways. It is but rarely that a man will admit even to himself that he is lacking in the highest order of executive ability. On the contrary, men who have never managed a successful business of any kind, and who could not run a corner grocery store with any degree of brilliancy, will cheerfully offer their services for the most responsible positions. If through any chance such a candidate has some basis upon which to claim consideration, as a large interest in the enterprise, or the influence of friends or relatives, then no matter what his lack of executive experience or ability, something more physically effective than moral suasion is needed to keep him out.

Notwithstanding its importance, there is often a singular indifference as to the character of the manager employed. An enterprise will perhaps be selected with the greatest care, money will be supplied freely for its proper development and operation, and then everything up to this point having been done in the best possible way, the directors of the enterprise look round for a cheap manager to put in charge.

Worse economy could hardly be imagined. A few hundred dollars a year may be saved on the manager's salary, but this is done at the risk of the whole enter-

prise, and is in itself the very worst of management. In a business of any importance the annual loss involved in poor management or in any management short of the best, would easily amount to many times the manager's entire salary.

In the selection of a manager the very patent fact should not be lost sight of that a failure to make profits that might be secured by good management, is as real a loss and almost as much of a blunder as to lose money actually on hand, and that a manager who fails to increase the profits when they might be increased, is but one stage in advance of the manager who depletes the reserves. Both lose money and it is only a question of amount.

It is a somewhat ungracious matter to point out failures of management, but such a striking illustration of the difference between good and bad management and of the importance of the former, is afforded by the well-known history of the A. T. Stewart establishment of New York, that we may be pardoned for a reference to the matter.

This enterprise was founded by Mr. Stewart and was worked up by him to the position of the largest and best dry goods store in the country. It was known in every part of the United States and was largely profitable. At Mr. Stewart's death the establishment was taken possession of by one of Mr. Stewart's associates, not so well versed in business affairs. As one of the first steps the well-known and—from a business standpoint—immensely valuable name of A. T. Stewart was dropped. Other almost equally unfortunate

changes were made, and the career of the magnificent business was diverted from the upward to the downward course so decisively that hardly thirty years was required for its financial involvement and the discredit and retirement of its management.

The business then again came under capable control under the name of John Wanamaker, who appeared as the successor of A. T. Stewart, the intervening regime being ignored. The course and policy of the business were altered, better methods were introduced, the business promptly responded and now once more stands, not as the leading business establishment of the country, but well up among the largest, best-managed and most profitable of its kind.

In the inception of an enterprise good management is peculiarly difficult to secure, but is peculiarly necessary. After running a number of years, a business is officered and managed by a process of natural selection. Men of the required ability are gradually secured as opportunity offers or work up to the places they are fitted for. The material is at hand, or comes to hand. It is then merely a matter of fitting the right man into the right place.

In a new business, however, there is no opportunity for the preparation and demonstration of managerial timber. The natural selection that obtains, or that may obtain, among the employees of an established business, is not possible. Neither are there usually any practicable methods of "trying out" a manager before he is employed. On the contrary his selection must be made for better or for worse on such informa-

tion as may be at hand or be obtained from others and his trial must be a practical one made at the expense of the business.

The most usual course in a case of this kind, where it is possible and where the importance of good management is recognized, is to draw a manager from some similar business or enterprise in which he is already successfully employed and in which his ability has been demonstrated. This, of course, involves the payment of a higher salary than the desired official is already receiving, and the plan is not always then successful, the amiable intentions of the new concern being frequently frustrated by a prompt increase of the manager's salary by the old company. Also there is some question of ethics involved in an attempt to withdraw a trusted employee from another establishment. Within reasonable limits, however, this is expected, is undoubtedly good business and is very frequently done.

If this plan is not feasible, a successful manager in some other line of business is likely to be a good selection. In this case, however, the qualifications of the proposed manager should be investigated with great care. His success may have been due to his very complete grasp of the details of his own business, rather than to his general executive ability, and in such case, coming into a new business, he might be an utter failure. It should also be borne in mind that the inauguration of a new business is a much more complex and difficult problem than its conduct when once in running order, and that a man who can successfully

carry on an established business may be totally unable to give it a successful start.

Another frequent source of good executive material for a new enterprise is found in the rising employees of other established businesses. In a large concern it is usually impossible for all the members of the force to be advanced as rapidly or as high as their abilities would justify. In such case, the employees unable to secure promotion in their own establishment are not only willing but anxious to secure employment elsewhere more suitable to their capacities. Frequently reliable information as to their ability and standing may be obtained direct from their employers, who are willing to assist their employees even though at some loss to themselves. Such information, taken in connection with the position the proposed manager is filling, the manner in which his duties are performed, and his general character and disposition, should give a very fair idea of his executive ability and the likelihood of his successful career in the new field.

CHAPTER V.

RELATIVE STATUS OF THE UNDERTAKING, CAPITAL AND MANAGEMENT.

The relative values of the three essential features of a successful enterprise cannot be fixed with precision. They vary too greatly with the conditions. Even in the same enterprise, they are held in varying estimation by the different parties concerned, according to the point of view to which their interests incline them.

Of the three essentials discussed in the preceding chapter—the undertaking, the money and good management—the author would, speaking generally, give good management much the highest place. All three are obviously necessary to the best success, but no matter how good the undertaking nor how liberal the supply of money, all may be ruined by bad management, whereas even a poor undertaking, or a good undertaking crippled by lack of money, will, unless the handicap is too heavy, be brought to a successful issue by good management.

While all this is theoretically indisputable, in practice management receives but scant consideration in the apportionment of interests. As a rule, capital and the undertaking get together, divide the prospective profits between them, and then look around for an able

executive who will work these profits out. They may pay their manager a large salary; they may give him some small percentage of the profits, or may even go so far as to give him an interest, or an opportunity to earn one, in the business itself. This, however, is the usual limit. As to any serious consideration in the general enterprise, the manager is literally not in it. He is fitted in afterward; if he prove a misfit, so much the worse for the enterprise. The conflicting claims of capital and the undertaking stand first and until these are adjusted, the importance of good management is practically ignored.

These relative values of capital and the undertaking are in a constant condition of fluctuation. If times are hard and the money market tight, or the individual bank account low, the man with money is coldly indifferent to the claims of the undertaking and must be approached with deference and with persuasive propositions. If, on the other hand, the financial conditions are easy and investment money plenty, capital and the undertaking meet on much more equal grounds and it is then a battle royal between them as to their relative status and the division of the spoils.

Again, if the proposition is one of unusual attractiveness and is properly presented, with its strong points brought into artistic prominence and its weaker features draping the far perspective, the undertaking, if financial conditions be favorable, has the vantage ground. Or if the proposition is desirable, and the parties presenting it have some financial strength of their own so that they can meet the capitalist with the

easy independence that inspires respect, the undertaking again occupies a superior position. Conversely, even though the undertaking be ever so good, if the parties presenting it are men of limited means, and, as is so often the case, utterly unable to carry the undertaking themselves or even hold it for any length of time, perhaps only controlling it under a short option, the conditions for the men with the enterprise are exceedingly unfavorable. Then those presenting it must usually take whatever proportion of the financed enterprise the capitalist is willing to allow them, which is not ordinarily excessive.

It must also be borne in mind that the apportionment between the owners and the men with money varies greatly according to the basis upon which the matter is considered. Men of large means, if interested in an enterprise, usually take it up in its entirety, and either alone or in connection with their associates supply or arrange for all needed funds. In such event they naturally expect to dictate terms.

If, however, the necessary funds are to be raised by the accumulated contributions of a number of smaller investors, there is usually no concert of action among them, no individual subscription is large enough to influence the proposition materially, and these small men must perforce, if they wish to get into the enterprise at all, accept the proffered terms. It is needless to say that these are far less advantageous than those secured by the larger investors.

As may be inferred, there is no general rule as to the division of interests between the parties controll-

ing the undertaking and those controlling capital. It may be said, however, that ordinarily where the enterprise is presented to men of means, these latter expect, and generally get at least a controlling interest in the financed enterprise. They may get more, or where the undertaking is very attractive or is presented under unusually favorable conditions, may take much less, but the general expectation of the man with money is that capital shall control. The man with the enterprise must recognize this position of the capitalist, and, if he considers this too much to give for the money he needs, must present the enterprise in such a way as to overcome the capitalistic contention, or on such a basis that the question does not arise. A full discussion of the presentation of the enterprise will be found in later chapters.

The position of the capitalist is not unreasonable. Money is essential. Without it nothing goes in the industrial world, and it is not astonishing if the capitalist, seeing the necessity and the power of money, gets a very much exaggerated idea of its importance and imagines that it is the one thing needful.

The phenomenon has no direct bearing on the subject under discussion, but, as the "man with the enterprise" gradually emerges from financial obscurity into the capitalistic class, the gradual conversion of his first indignant denunciations of the position taken by the "man with the money" into first indifference, then acquiescence, followed by complaisant regard and finally by approving adoption, is, to say the least, very significant of one trait of human nature.

Apart, however, from any exaggerated respect for money, the capitalist has some grounds for his position. Theoretically the undertaking and the capital for its operation are integral and equally important parts of the one industrial project. They participate equally in the risks and, with due regard to any differences in the original values involved, should participate equally in the profits. In other words, the arrangement is a partnership of capital and property, and, from this point of view, should be governed by the usual partnership regulations.

From the practical standpoint, however, the situation is far different. The enterprise is unproved, while capital is of an established and known value. The enterprise is the possibility; capital is the realization. Capital is recognized all over the civilized world and may be converted into the local standards of value of any place by a simple operation in exchange. It is the substance of things only hoped for in the enterprise, and may be transmuted at any time into food, clothing, houses, automobiles and other desirable things on a fixed and well-known basis. The enterprise cannot. Capital is the gathered harvest. The undertaking is merely the soil of more or less unknown possibilities, which must be plowed, sown and carefully tended, and from which, if all the perils of flood, drought, storm, frost, insects and other destructive threatenings are safely passed, a more or less plentiful harvest of capital may at last be reaped.

The hard-headed capitalist does not, ordinarily, reason so lengthily as a basis for his demands upon the

enterprise. He merely recognizes the fact that money is hard to get and heavy to hold, and that he has got it, and usually governs himself accordingly. The word "usually" is employed advisedly, as even capitalists occasionally lose their mental balance and pour their treasured reserves into Keely motors, sea-water gold, and other equally alluring rat-holes with most surprising cheerfulness and prodigality.

The owner of the ordinary enterprise does not, however, meet with any such pleasing reception. He usually runs counter to the capitalist on the hard-headed side and must show a reason for the hope that is in him. Ordinarily the reason must be a very sound one. If it appeals to the capitalist he will consent to consider the undertaking. If he finally approves of it, he will then agree to invest the least possible amount of money that will apparently suffice to prove the undertaking, and for this will exact the utmost interest that can, under pressure, be extorted from the man with the enterprise.

As to the basis of the capitalist's demand for the control of the enterprise, we can do no better than to quote the utterance of a prominent New York capitalist to parties who were seeking to interest him in a particularly promising scheme. "You need my money to make this a success. You will not get it unless you give me a sufficient interest to make it worth while. Also, as I don't care to put my money and property into the hands of other people, this interest must be large enough to give me control."

This puts the capitalistic position very briefly and

very clearly. From his point of view it is but ordinary common sense, and the man with the enterprise must recognize this position and govern himself accordingly.

It must also be borne in mind that the capitalist is usually an able man of affairs, familiar with the methods by which the successes of the industrial world are obtained, and speaking generally, far better qualified to manage and direct the financial features of an enterprise than is the original owner, or the parties by whom the enterprise is controlled. His management and control should, of course, be under such suitable regulation and restriction as will protect the parties bringing the enterprise. These regulations need not in any way interfere with its proper business management. If the capitalist is acting in good faith, he is usually quite willing to agree to all reasonable provisions to this end. If he is not, the man with the enterprise would better go further, for he can certainly fare no worse.

PART II.—INVESTIGATION OF AN ENTERPRISE.

CHAPTER VI.

IMPORTANCE OF INVESTIGATION.

Possibilities of new commercial activity exist everywhere and are constantly arising. A ledge of marble is discovered on a New England farm; a Texas rancher finds himself the owner of a mountain of yellow ochre; a Nevada prospector stumbles on a vein of mineralized quartz; an inventor brings out a new typewriter or a system of wireless telegraphy; the capitalist lays his plans for the consolidation of rival railroads, the formation of a trust or the development of a new process.

In many cases the original owners of these possibilities are either unaware that they possess an enterprise—or the basis of an enterprise—or are unable to finance or develop it if they know of its existence and it lies dormant until taken up by some neighbor, friend or outside promoter. These promoters may themselves secure the money needed for the enterprise, or they may pass it along to other promoters who interest capitalists. These latter may keep the enter-

prise themselves, or may sell it, or perhaps capitalize it and offer the stock for public investment.

When any one of the thousand and one possibilities of the business world is brought forward, no matter by whom or in what stage of its progress to complete development, the first question—and from a business standpoint, the most important question—is, “Will it pay?” This question can only be answered by investigation. It is obvious, then, that this investigation is of the most vital importance to every one interested, whether owner, promoter, operator or investor. Upon its thoroughness, intelligent direction and accuracy depend the safety of the investment and to a very large degree the whole future of the enterprise.

Notwithstanding the importance and the very elementary necessity of such precautions, enormous sums are lost each year simply because the proper investigations of enterprises are not made. Too often those promoting an enterprise are quite willing to take chances themselves and apparently think that what is good enough for them is good enough for their friends or such portion of the public as they may induce to invest. At other times investigation is omitted from absolute indifference. More often it is the result of ignorance as to what should be done, or to a mistaken economy, or to actual lack of the funds required. Not infrequently this neglect of the proper investigation is carried so far that in connection with subsequent representations it becomes absolutely fraudulent, and many a promoter of this stripe has escaped a prolonged residence in the jails of the country only

from the reluctance of his victims to spend the requisite money to put him there.

Examples of the indifference of both promoters and investors to the necessity of investigation are numerous. Mining propositions are offered with defective titles; inventions are financed while unprotected by patents; companies are organized to operate under licenses which convey little or nothing; factories are established to manufacture products for which there is no sufficient demand, or are erected in places where raw material is not available or where markets are too distant; worthless mines are developed at great expense; railroads are constructed like the one financed by Col. Carter of Cartersville, which, as described by an unfriendly critic, "began nowhere and ended nowhere." Such enterprises are familiar to all.

A case in point occurred some years ago in the writer's immediate knowledge. An inventor of considerable reputation and some achievement stumbled upon a new principle in the construction of phonographs. The idea seemed reasonable and promising—so much so that when he approached a few friends with a proposition for money to construct experimental apparatus, his proposal was promptly accepted. As soon as terms were arranged, a machinist was employed and construction work began. All went well for a few weeks until one of the parties concerned—who, it may be said, was himself an attorney—while looking up patent matters connected with another enterprise, thought it well to see what had been patented in the line of their own undertaking.

His investigation quickly resulted in the discovery that some years before Prof. Bell, of telephone fame, had discovered and fully patented everything the little syndicate was striving to accomplish. The enterprise came to an abrupt conclusion.

In this case no investigation of any kind had been made. Sometimes, however, even when an investigation is undertaken, it falls short in some vital detail. An instance of this kind within the knowledge of the writer, so frankly a failure that no exception can be taken to its citation, may be given.

In a somewhat distant part of the country, a heavy vein of sandstone asphalt had been discovered and it and its surroundings investigated with considerable care. The quantity proved entirely sufficient, the quality was reported as excellent by experts, the vein lay in a position to permit of easy working from the surface down, the location was readily accessible, good roads already existed to a shipping point but a few miles distant, and an easily graded right of way was available for the construction of a railroad spur into the property. All the conditions seemed favorable and money for the development of the property was contributed freely.

The general manager, a pleasant, affable gentleman, of good standing and fair general ability but entirely lacking in successful experience in the asphalt business, was selected from among the stockholders and placed in charge. He took hold with much energy and enthusiasm, built a little village for the accommodation of his employees, with office, store, church and school-

house, all complete and in thoroughly good style, installed a first-class refining plant of a design in successful use in another part of the country, put in all necessary apparatus for the mining and handling of the material, graded the railroad right of way, piped in a water supply and generally prepared for the active operations anticipated.

Upon the completion of the installation, an experimental run was made and it was then discovered that owing to peculiar conditions existing in the deposit, the refining apparatus was absolutely ineffective. The difficulty could not be overcome; the whole enterprise fell through and the investment amounting to over \$40,000 was an almost total loss. The deposit, as it stands, is still awaiting development and may be purchased with all its improvements at a heavy reduction from first cost.

In this case the investigation had stopped just one step short of the proper point. A test run of a small quantity of the material in an operating refinery at some other asphalt plant would have shown at a comparatively trifling expense that the machinery was not adapted to the work. Or, if this was impractical on account of the rivalry existing between the different asphalt refineries of the country at that time, the obviously prudent alternative would have been the construction of a small working model of the machinery which could have demonstrated its ineffectiveness at a moderate cost. Or, if a working demonstration with full-sized apparatus was essential, the installation might have been made piece by piece, each piece being

tested before the next was begun, and no expense beyond being incurred until this was done. The point of weakness would then have been discovered before any considerable expenditure had been made.

Any of these methods would have involved some little delay, but, as it turned out, would have saved many thousand dollars of money and the year or more of time that was thrown away on the costly development of a striking fiasco.

In the case cited there were no serious obstacles in the way of a full investigation. It sometimes happens, however, that the parties most interested—the owner, promoters or even those putting money into the enterprise—will themselves stand in the way of a proper investigation. In some cases there is no direct refusal to investigate, but it is simply not undertaken as unnecessary, of too much trouble or too great an expense. In other cases, however, a proposal to investigate the merits of an enterprise is met with a deliberate and sometimes very emphatic refusal.

Such a refusal may be due to one of several reasons. Fraud is the most obvious inference but the inference is frequently at variance with the facts. Sometimes, such a refusal is due to the perhaps half-acknowledged feeling of the parties that they would rather have a good run for their money—or the money of their backers—and test the enterprise by actual development, than to have it nipped in the bud by the unfavorable opinion of some hard-headed expert who might of course be mistaken in his report on that particular enterprise. Again, a refusal will arise from a

fear that an investigation of the enterprise, which may be an unpatented invention, an unprotected process or an unsecured property, may lead to its loss. Occasionally a refusal results from an honest belief that such investigation will not be a fair one, or will be conducted by improper or incompetent parties.

In both of these latter cases, it will be recognized that the refusal may be entirely justifiable, not necessarily indicating fraud in the enterprise or even an unreasonable disposition on the part of its owners or promoters. Speaking generally, however, when the proper investigation of an enterprise is refused or evaded, the enterprise involved should be viewed with deep suspicion, and unless some satisfactory method for its investigation can be agreed upon, should be left severely alone. There are people—of the kind who are soon parted from their money—who enjoy the gamble of backing an uninvestigated proposition, and their amusement should not be interfered with by any other class of investors.

It may be said that people very frequently do go in with an inventor or discoverer on a sort of "blind pool" basis, with very inadequate, if any investigation, possibly nothing further than a general discussion of the matter with the party presenting the enterprise. In such case they trust that the party in charge will materialize his expectations so far at least as to bring them out whole, and they hope for a great deal more. Such an investment, while entirely legitimate, is purely speculative and wholly outside the realm of ordinary business. It is a "grub-staking" proposition with the

odds much against the parties putting up the money.

Instances of such investments are familiar. But a few years since a very skilful chemist of much repute in synthetical work spent a term in jail as an incidental result of just such an undertaking. He either had, or professed to have discovered a formula for the synthetical manufacture of camphor. In other words, he claimed to be able to produce camphor by the combination of chemicals. He also claimed that he could do this at a price far below the cost of the natural gum.

The chemist's claims were naturally received with respectful consideration, and though backed up by nothing further or stronger than his own statements, were deemed of sufficient importance to justify the construction of an experimental plant. Accordingly a well-known firm of manufacturing chemists advanced \$15,000 for the construction and equipment of a laboratory for the demonstration of the process and for the manufacture of the camphor thereafter.

The demonstration was, however, in a sense a failure, as the chemist, instead of expending the money in laboratory construction and in the production of the gum, diverted it to his own personal use. Whether he really was able to manufacture camphor synthetically has never been divulged.

In this case the claims of the chemist were very direct, were given plausibility by previous discoveries made by him, and the rewards of success were so great as to perhaps justify the risk of the money. It was, however, a pure matter of taking chances and apparently in this case the chances went wrong.

Possibly the most notorious case of a "blind" investment in modern times is that of the Keely motor. The details of this very remarkable enterprise are interesting but are far too complicated for narration here. It is sufficient to say that for over twenty years Mr. Keely maintained the secrecy of his work, never showing any practical results and always refusing to permit investigation beyond a certain point. He was willing to show the results of his alleged wonderful force, or application of force, but any proposition looking to a real investigation was either met by a direct and very positive refusal, or was led astray by a cloud of meaningless words and phrases, that were seemingly held in reserve for just such occasions.

Meanwhile Mr. Keely's backers, who were business men of the highest personal and financial standing, stood by him year after year through disappointment and postponement constantly recurring, and never seemed to tire of pouring their money into the hopper of the mill that Mr. Keely's motor was turning. Finally it was stopped by the death of the principal actor. Then, and not till then, the secret was revealed and they found that instead of an unsuccessful inventor, they had been dealing with an unusually successful impostor. The hundreds of thousands of dollars invested in the alleged discovery were hopelessly lost.

The history of the Keely motor merely emphasizes the general proposition that where investigation or publicity of a proper kind is refused, the enterprise should be avoided. With an honest and meritorious enterprise there is always some way of disclosing or

proving it so that without injury to the enterprise, its intending backers may be properly acquainted with its merits—or lack of merit. If this cannot be done, it is a fair presumption that something is wrong with the undertaking.

The truth of this could hardly be better illustrated than by the well-known and somewhat unhappy experience of sundry Boston capitalists in the late '90's. The scheme was one for the extraction of gold from sea-water. It is a well-known fact that gold occurs in sea-water in minute quantities. The inventor of the "scheme" announced his discovery of a process whereby it might profitably be extracted. Experienced in the art of extracting gold from credulous humanity—no matter what his ability may have been to extract it from sea-water—the inventor constructed a mysterious plant, mostly under water and therefore conveniently out of the way of investigation, at a secluded spot on the New England coast, procured a supply of gold dust and commenced his operations. Boston was selected as the most promising field for the active operations of the general scheme and some of the alleged sea-water gold was freely exhibited in evidence of what was then doing. Naturally some unbelief was manifested, but the "doubters" were invited to accompany the inventor to the plant and see the thing done.

The following extract from an account of the swindle gives an interesting view of its operation:

"Investors and investigators were always received cordially; in fact, many of them were brought up by Jernagan, the inventor himself. They were shown

everything except the secret process. They examined the empty accumulators; they were told that these were connected with the apparatus in the secret chamber; they saw the raw material brought out from the accumulators each morning, and in the laboratory they saw the gold being extracted from the mass; above all, they saw the ingots or bricks which were being sent down to the United States assay office, and they saw the reports of the assayers there, declaring the value of the gold and silver thus received. As for the process, Jernagan refused to give any explanations of any kind. That was his secret; they might see the preparations, they might see the results, and if they were not satisfied with these, it could not be helped. Usually they were satisfied, and put in their money."

Nearly a million dollars was put into the swindle by Jernagan's victims. Jernagan himself disappeared about this time, the secret of his "process" disappearing with him.

In conclusion it may be said that the ready acceptance of claims or statements without adequate investigation not only leaves the door wide open for the perpetration of deliberate fraud as in the instances just cited, but also makes possible the more or less unintentional frauds and the honest mistakes so frequent in the history of financing, resulting in the investment of large sums of money in worthless, deficient or impossible enterprises. No matter by whom the enterprise is taken up, whether by the owner, inventor, promoter or investor, nor for what purpose, its thorough investigation cannot be neglected save at the most serious risk of failure and financial disaster.

CHAPTER VII.

METHODS AND RESULTS OF INVESTIGATION.

The investigation of an enterprise should be undertaken primarily by its owner or by the party who first undertakes its financing or development. A proper investigation is, however, equally important to those who come into the undertaking later, and unless these latter are willing to accept the results already attained, it is probable that the enterprise will be investigated again—perhaps many times, as the conditions and interested parties change. The investigations already made may not have been of sufficient thoroughness or scope, or the later parties may wish to complete, extend or verify them, or an entirely new and independent research may be deemed advisable.

When undertaken by the original owner or promoter, investigation is usually for the purpose of ascertaining whether the enterprise gives sufficient promise of returns to justify the time, trouble and investment involved in its financing, development or operation.

Those who come into the enterprise later investigate for the purpose of determining the safety and the profit of the undertaking. This investigation will naturally extend somewhat further than that of the original owner or promoter, for not only must it cover

the ground of the investigations already made but must in addition include any changes in the original conditions due to the work of the owner or promoter.

It is obvious that these different investigations, though conducted at different times and by different parties, have the same general end in view, *i. e.*, the determination of the value of the enterprise. The considerations of the present and succeeding chapters will, therefore, apply equally to any investigation, whether made by the owner of the enterprise, or by a promoter considering its financing, or by a moneyed man considering an investment. It is to be noted, however, that the investigations here considered apply only to the natural features of the enterprise. If company organization, management, stock issues and other matters of the kind come in question, the scope of the investigation is considerably extended, as indicated by "The Investor's Questions," in a later chapter of the present work.

When an investigation is undertaken, it will usually include features peculiar to the particular enterprise. Beyond these it will extend to general features which affect the majority of enterprises and which, unless already known, must be fully investigated. These general features may be roughly classified as follows:

- (1) Basis of enterprise.
- (2) Title.
- (3) Output.
- (4) Environment.
- (5) Conditions of operation.

Under each of these heads several points are to be considered.

(1) Basis of enterprise.

(a) Does a substantial basis for the enterprise exist? This may seem almost too elementary a query to be included, yet it is often disregarded. The men who financed the Keely motor so liberally took chances as to this and lost several hundred thousand dollars in the "gamble." Not many years ago stock was sold quite extensively in a South African diamond mine that existed only in the printed matter of the thrifty promoter. Gold mines very conveniently located in the valley of the Hudson near New York City, have been announced and financed more than once on no better basis than a find of pyrites or "fools' gold."

(b) If a process or invention, will it do what is claimed for it? This is merely a different form of the preceding query. Frequently the construction of a working model or complete machine, or perhaps the development of the whole enterprise, is necessary before it can be answered.

(c) Are similar undertakings in operation elsewhere? If so, some idea—and frequently a very definite idea—of the prospects for success can be obtained by a study of what has been accomplished at these other places.

(2) Title.

Is the title, involved, whether deed, transfer, patent, assignment or bill of sale, good or sufficient? In considering a purchase of ordinary real estate no pains are spared to investigate and guarantee the title. In other

matters the same care is not observed. Defective titles to mines are always turning up; inventions are first financed and their patents are looked up afterward; interests are taken in contracts which are later found to convey little or nothing.

It is to be noted that doubtful titles, or titles that are not perfect, are at times the best that can be secured. These imperfect titles must then be carefully considered to determine their sufficiency.

(3) Output.

(a) Is there a sufficient and profitable demand for the output? The output as here considered is anything from which the revenues of the enterprise are derived, as the coal from a coal mine, the publications of a publishing company, or the transportation facilities of a railway system. It is obvious that an enterprise cannot be profitable unless a sufficient demand exists for its output. At times, however, as discussed later, to determine this point in advance is difficult if not impossible. In enterprises of a certain character it is frequently the one unknown quantity.

(b) Is or will the output be sufficient to support operations and supply the demand? Naturally the supply must be large enough for profitable operations, or the enterprise is not likely to be undertaken; but beyond this, if it is not sufficient to meet the demand properly, competition is invited or the demand itself may be discouraged and seek other sources of supply. In either case failure or loss might result.

(c) Is the output of proper quality to meet the demand? If the enterprise be a mine, the quality of

its output is usually fixed by the natural conditions and cannot be changed. It then becomes necessary to ascertain whether this quality is that required by the demand that is to be satisfied. It is obvious that this quality may be too high or too low. For instance, a high grade, brittle asphalt, excellent for varnish and paints, would not be at all suitable for paving. Or a low grade coal carrying much sulphur and phosphorus could not be used for the manufacture of a fine steel, though it might be quite good enough for general use. In most mining enterprises, however, the quality cannot be too high, the product being more valuable as its purity or grade increases.

If the enterprise be the production of some manufactured article, its quality can usually be adapted to the needs of its market. The output in this case may, however, be fixed as to quality by the character of the raw material supply. For instance, a fine steel could not be produced from iron ores containing a high percentage of phosphorus, nor could a fine china be produced from a coarse potters' clay.

(d) Can the product be turned out at a figure that will make operations profitable? This is obviously one of the essential points and one that usually requires consideration of a number of contributing elements before it can be properly answered.

(4) Environment.

(a) Are any necessary raw materials readily available? The raw materials must either be at hand, or the transportation facilities must be such as to render

their delivery in quantity and at low cost easily possible.

(b) Are water, fuel and other necessary supplies readily accessible and at reasonable cost, or at a cost that will permit of successful operation?

(c) Can labor be secured at a reasonable price and in sufficient quantity? Usually the resident population will furnish a sufficient supply. Sometimes this may be supplemented by the importation of labor. If the labor must be skilled, the matter is more difficult. In such case if the region is a new one for that particular industry, the labor required must be imported, or perhaps only a sufficient number of skilled laborers to begin on a limited scale will be brought in, and operations be enlarged thereafter as resident labor is educated up to the requirements of the enterprise.

(d) Are the markets readily accessible and are the transportation facilities adequate and reasonable as to cost? Instances are perhaps familiar to most of our readers where enterprises have been ruined, or, conversely, have been built up by railroad discrimination. It is not, therefore, sufficient in itself that the markets are readily available. The disposition of the railroads must be ascertained.

Not only must rates be favorable but transportation capacity must be adequate. No matter how favorable the rates, if transportation cannot be secured when needed, the profits, or even the existence of the enterprise, might be seriously endangered. If water transportation is available, it will probably be cheaper and for many purposes preferable, and should be carefully

investigated even though rail transportation is at hand. If not needed at the time, it will serve as an alternative in case of subsequent harsh treatment by the railroads.

(5) Conditions of operation.

(a) Is competition to be encountered? Some few enterprises are so fortunate as to have no competition. Usually, however, competition is more or less severe, and is a factor which weighs heavily in considering the prospects of success. First must be considered any existing competition. This competition has the very material advantages of an established trade and income. Then the possibilities of new competition must be taken into account. If the enterprise is a success, and other concerns can come in and secure exactly the same facilities, competition is usually to be expected and should be guarded against in advance.

(b) Do any local conditions exist which would specially affect the enterprise? It is obvious that the vicinity of a boiler factory would not be a desirable location for a "rest cure" establishment, nor should a meat market be established in a vegetarian colony, nor would it be wise to make Oklahoma the headquarters of a trust. These are extreme illustrations, but it will be seen that investigation of local conditions is very essential.

CHAPTER VIII.

SPECULATIVE AND NON-SPECULATIVE ENTERPRISES.

The scope and results of investigation in any particular case will depend largely on the nature of the enterprise. For the purposes of the present consideration, enterprises may be regarded as divided into two classes—non-speculative enterprises, in which the uncertain quantities may be so far eliminated that the undertaking becomes one of ordinary business risk; and speculative enterprises, in which the unknown quantities cannot be determined with accuracy and in which the risk is greater—and usually much greater—than in the ordinary business enterprise.

Speculative enterprises may be further divided into those of a semi-speculative nature and those of a purely speculative nature. This distinction is entirely one of degree. In the semi-speculative enterprises the uncertain quantities may usually be worked out at a comparatively small expense, or perhaps by partial development, while in the purely speculative enterprises some pretty full measure of development must be attained before the real value of the undertaking can be determined. It is, naturally, the object of the promoters of a speculative enterprise to bring it as quickly as possible to the basis of an ordinary business

risk—that is, to the point where it passes from the realm of speculation and becomes an investment proposition.

Enterprises which merely involve the ordinary business risk may usually be investigated and their merits and possibilities determined in advance with considerable accuracy. In many cases this is attained at a comparatively small cost, and in the case of established lines of industry, by the simplest procedure.

For example, suppose a cotton mill is to be established in a Southern state. The general conditions of the industry are well known, and for the man familiar with the work, require no investigation. He will, however, have to study the special features of his particular proposition. He must ascertain whether a sufficient supply of the raw material is within economical reach and whether labor at a fair price is at hand or obtainable; also whether fuel and water supplies are available and whether transportation to his markets is adequate and reasonable as to cost. The possibility of securing a suitable site, of erecting the necessary buildings and of bringing in the required machinery, all at reasonable figures, must be investigated, as also any local laws or conditions specially affecting the enterprise.

When the mill man has determined these matters, the details peculiar to that particular proposition are pretty well covered. The rest is a matter of common expert knowledge. The uncertain quantities have been determined and there remains only the working out of the equation. This can be done with such accuracy

that to establish an unsuccessful cotton mill is, under ordinary circumstances, a standing and deserved disgrace to those responsible.

In an undertaking of a semi-speculative nature most of the conditions are still known or may be ascertained by an ordinary investigation, and the elements of uncertainty are usually confined to a few points which may be determined without the expense, trouble and loss of time of a complete development.

The history of type-setting machinery affords a number of good illustrations of the semi-speculative enterprise. Here the only unknown quantity or uncertain element of the whole undertaking was the possibility of producing a machine that would rival the work of the hand compositor, or approach it closely enough for practical use. Everything beyond this was a matter of common expert knowledge.

This problem was undertaken by a number of inventors. Failures were numerous. The most conspicuous of these was perhaps the Paige machine, which was brought into unusual prominence by Mark Twain's connection with the enterprise, as well as by the ingenious intricacy and mechanical beauty of the machine itself.

Mr. Clemens understood printing and its requirements, but was a pessimist as to the possibility of a practical type-setting machine. His first investment in the Paige machine was therefore a comparatively small one—\$2,000—and was made without investigation; in fact, more to accommodate the promoter than anything else. Shortly after, he went to look over

the new machine and was amazed to find it actually setting and distributing type, and, in fact, doing everything that it was called upon to do save the justification of the lines.

Mark Twain was entirely familiar with the demands of type-setting; and when he saw the machine apparently meeting the requirements, so sure was he of the practicability of the machine that he at once invested an additional \$3,000. The inventor, however, was a visionary and was not satisfied with what he had done. He must have a perfect machine—one that would “justify.” For five years he worked on and the machine was still unfinished. He then called on Twain, explained that \$30,000 was needed to complete the machine, and offered Twain a half interest for the money. Mark Twain agreed, but stipulated that thirty thousand dollars must be the limit, and the work went on.

So rosy did the prospects of the machine seem at this time that the promoters of the Mergenthaler linotype offered to exchange a half interest in their machine for a half interest in the Paige machine. The offer, however, only confirmed Mark Twain’s high opinion of the Paige machine and he did not care to divide honors and money with the linotype.

The \$30,000 was exhausted, and the machine was still incomplete. But \$4,000 more would finish it. The old machine had been discarded, and the inventor was building a new one—one containing twenty thousand parts, each of which must be made according to its own special pattern. The \$4,000 was exhausted

but the calls for money continued and were met by Mark Twain. The Mergenthaler was then just coming on the market, but the Paige machine was still incomplete, and Twain was finding it more and more difficult to meet the demands for money. Finally it became impossible, and the machine, representing an investment on Twain's part of almost \$190,000, was dropped. It had been an "old man of the sea" to Mark Twain for almost ten years.

The history of the linotype machine is as striking an example of success. In this an entire departure was made from the principles employed in any prior type-setting machine. Instead of employing the ordinary type of the composing room, the inventor took the ground—at that time entirely novel—that the successful machine must make its own type and do it in such a way that the ordinary difficulties of mechanical type-setting would be avoided. The movable type idea was therefore abandoned. In its place was substituted the line idea, the machine when operated setting type molds in place and on completion of each line casting the now well-known linotype slug. This forms in one solid piece a complete line of type matter, and from this feature the machine derives its name.

This very radical departure from the usual plan involved numerous elements of uncertainty. Many new functions were to be performed by the machine. It must include a small furnace where molten type metal might be kept ready for use; it must have matrices for every letter and character used in English composition; it must be capable of arranging these

letter matrices into words, and these words must be spaced evenly in the line. The line of matrices must then be used as a mold and this mold be filled with the melted type metal. The solid line of type so formed must be delivered on the galley, the matrices making up the mold must be distributed to the magazines from which they came, ready to be used again, and all this must be done, and well done, at a high rate of speed. In short, the machine must perform all the operations of a composing room and of a type foundry, at the dictation of a single operator. The plan was original and striking. Its execution was equally daring and brilliant.

Details of the numerous mechanical difficulties that were overcome, and of the unfortunate differences between the inventors and constructors of the machine, are unnecessary here. It is sufficient to say that the idea was worked out to operative perfection—first so that the machine could be profitably employed, principally on account of its rapidity, on rough newspaper work, then, as the mechanism was still further perfected, on book work, and beyond this, yet further, until now it is used in almost every branch of the art. It has been and is a complete and striking industrial success, and the profits to those connected with it have mounted up into the millions.

In both the cases cited, investigation was conducted intelligently and as far as was possible. Most of the conditions were known. The question of patents was perhaps not absolutely certain, but was sufficiently so to be left for future determination. In either

case the only material uncertainty was as to the construction of an acceptable operating machine. In both cases the possibilities, both of loss and profits, were clearly recognized and accepted in advance. In the one case the matter was successfully worked out; in the other it was not. It is to be noted that in the case of the linotype, as soon as a practical operating machine had been constructed, the whole enterprise was removed from the speculative class, its one element of unusual risk having been worked out. Thereafter it was an investment enterprise depending mainly on good management—which was forthcoming—and liable only to the risks of ordinary business.

In the more purely speculative enterprises the uncertainties extend further than in the instances considered—so far, in fact, that the only way in which the value of the enterprise may be conclusively determined is by actual development. Thus in the case of many mining prospects and many inventions, the only satisfactory investigation is by an actual trial—that is, by a more or less complete development. As a consequence, such enterprises, while usually holding out large possibilities of profit, also involve a very large measure of risk, which can only be avoided by avoiding the enterprises.

A familiar illustration of a speculative enterprise is furnished by wireless telegraphy. In this case there was but little room for the ordinary investigation. The demand for telegraphy was undoubted and extensive. The conditions surrounding its commercial use were well known. Patent protection for wireless

apparatus could unquestionably be secured to any reasonable extent. The element of uncertainty was the possibility of devising a wireless system capable of operating so effectively and economically as to build up a business of its own or otherwise be able to compete successfully with the existing ocean cables.

Here, physics as well as mechanics were involved. Natural laws before unknown, and even now seen but darkly, were to be studied. Mechanisms for their utilization were to be constructed. It is plain that the uncertain features of the enterprise were material, and from their nature, could only be determined by a more or less complete development of the whole enterprise.

The seriousness of these uncertainties is shown by the fact that while the Marconi Company was organized over fifteen years ago and active work has been in progress ever since, no great financial success has yet been achieved. The value of wireless telegraphy as a means of communicating between vessels at sea and between these vessels and the land, and even across the ocean, has been amply and brilliantly demonstrated, but the business in this field has not so far been sufficient to make the company a real success.

Further, the stockholders of the Marconi Company not only took chances on the success of wireless telegraphy, but specifically on the success of the Marconi system of wireless telegraphy. Their risk extended beyond the success of the general system. Wireless telegraphy might be a failure, beyond its first limited application, and the Marconi people lose. Wireless telegraphy might be a success, but Marconi's competi-

tors might distance him in the race and the Marconi Company still lose; or possibly new discoveries might relegate the whole system of wireless telegraphy to an industrial limbo before the coveted goal was reached by any one. The enterprise was well classed as extra-hazardous, and one which must needs be extra profitable to repay the original investors for their risk.

CHAPTER IX.

INVESTIGATION OF A NON-SPECULATIVE ENTERPRISE.

The investigation of an enterprise well within the established lines of industry is usually a simple matter, especially if the interested parties are themselves versed in the particular line and capable of making the necessary investigation.

When these conditions do not obtain, the services of experts must be secured. If not already known, names and addresses of such experts—in all those lines in which independent experts are found—may generally be obtained from the advertising columns of the trade journals published in the interests of the particular industry. If not, a request to the publishers of such journals will usually procure the desired information.

It is obvious that an expert employed for any investigation of the kind should be competent and reliable. It may be that the expert selected is well known to the parties, or is of such standing and reputation as to guarantee his fitness, but if otherwise, his qualifications should be looked up with great care. Such an investigation is not usually one of difficulty, the expert himself furnishing the references and other data necessary for this purpose. Nothing should, how-

ever, be taken for granted. If references are given they should be written to, or if statements are made as to work done, they should be "checked up." It occasionally happens that an alleged expert will give references of the highest character, knowing perfectly well that these parties will not endorse him, but hoping that no enquiry will be made.

An expert will either undertake the entire investigation of an enterprise or, if desired, will confine his examination to the more technical portions, leaving matters of ordinary detail for the parties by whom he is employed. The price of his services will range anywhere from \$10 a day upwards, averaging usually about \$25 per day and expenses when an "out-of-town" investigation is to be made. Or a lump sum will sometimes be agreed upon for a particular examination. These expert services are usually worth the full price paid, but as a measure of precaution the cost of any investigation should be agreed upon in advance.

The examination made by an expert, unless restricted, usually extends to all the essential features of the undertaking. His report, especially if favorable in its tenor, and good both in manner and form, is not only of immediate value but is also most useful in any subsequent financing of the enterprise. If the expert is thoroughly qualified, his report will probably be in shape to be used for this or any other proper purpose. If not, it is in no way improper to request its re-arrangement. The subject matter of a report is, of course, absolutely and entirely within the province of the expert and not to be interfered with, but the

manner and form, if defective, are not entitled to any such respect.

In any investigation of great importance, a single report is not usually deemed sufficient, even though the standing of the expert be high. It is but seldom that an expert of reputation can be "purchased," but he may occasionally be swayed by outside influences and there is, of course, always a possibility of error. Also it frequently happens that special points require further investigation. Therefore when important matters are under consideration, several expert investigations are often made.

When an enterprise has features entirely new or outside the realm of established industry, the problem of investigation is one of much greater difficulty, requiring some modifications of the usual methods for its proper solution. Also, regardless of the nature of the enterprise, the manner of investigation will vary to a greater or less degree with the particular undertaking. The matter may perhaps be best illustrated by a discussion of methods that have been actually employed in the preliminary investigation of different enterprises.

The first of these investigations was a somewhat singular one, the enterprise partaking of the marvelous and mysterious in its nature quite as much as did the Keely motor on its original presentation. It was in short nothing more or less than the transmutation of metals, the party in control claiming to have discovered new natural laws enabling him to convert the ordinary spelter, or zinc, into high-grade brass at a

total cost for labor and materials of from five cents to eight cents per pound. As the principal constituent of brass is copper, the claim, if verified, amounted to the profitable and commercial conversion of zinc into copper. Ordinarily in New York business circles a proposition so remarkable would have been dismissed with mildly interested scepticism. In the present instance, however, the gentleman presenting the proposition was at the head of an active and successful manufacturing enterprise in which the metals involved were largely used and his personal intelligence, ability and commercial standing were such as to warrant attention and a certain amount of confidence in his statements.

Very handsome samples of the transmuted metal were submitted for examination. Satisfactory explanations of the necessity for capital were forthcoming. The offer made was unusually fair and straightforward, involving no payment to the inventor of any kind except from profits. Finally the process itself was vouched for so strongly and with such frank plausibility by the gentleman presenting it that the matter was at last with many misgivings, taken up by the New York house to which it had been offered.

The process was naturally a secret one, but the owner agreed to make any demonstration required, providing only that the actual secret of the process should be retained by him until final contracts had been entered into. As soon as these had been executed, the process was to be revealed to some trustworthy and competent party to be mutually agreed upon. Then, under the supervision of the two, the manufacture

would be at once begun, and so soon as an adequate output was secured, the copper markets of the world would be controlled by the parties concerned, together with resulting wealth, "beyond the dreams of avarice."

The inducements were attractive, the proposition was "right," the conditions were reasonable and the whole thing then hinged on the results of an investigation of the process. The parties looking into the matter were promoters who, in event of a successful demonstration of the process, had undertaken to secure all necessary capital for the enterprise.

In this case most of the factors were known and the investigation at once narrowed down to the two points: 1. Could the transmutation be made? 2. Could it be made within the price named, or at a price that would make the process commercial? The value of the whole enterprise would be established if these two points were satisfactorily settled, and they were of such a nature that an absolute demonstration was entirely possible.

As a preliminary step the samples of the alleged transmuted metal were submitted to a well-known and skilful chemist for analysis. It is to be noted that this step was out of the logical order as an analysis would come in due course when brass was produced in the test of the process. It was undertaken at this time merely as an incidental "bracer," only necessary or desirable because of the very remarkable nature of the whole proposition. The results of the analysis fully confirmed all claims as to the grade of the brass, a

good-sized nugget of copper being secured from the brassy samples submitted to the chemist.

The investigation of the inventor's ability to effect this interesting transformation was then undertaken. A preliminary demonstration at his laboratory in a nearby city was completely successful, beautiful samples of brass being produced, apparently from ordinary spelter. Something less open to manipulation than this laboratory test was, however, essential, and a more formal demonstration was therefore arranged for in a foundry near New York. To make this the more complete and satisfactory, and to guard against fraud, all the preparations were made and materials furnished—except the very small quantity of transmuting material necessary—by the investigating parties, the inventor merely indicating the necessary temperature of the furnace, the quantity and quality of the spelter, the size and kind of crucible required and even agreeing to accept the assistance of one of the regular foundry helpers in place of his own trusted assistant. All this looked very open and fair, everything necessary was done and at the appointed time the inventor put in his appearance.

The test was picturesque to an unusual degree. For the sake of privacy, it was conducted in a small detached smelting room with murky walls and bare beams, blackened and discolored by age and metallic exhalations, and crowded with the apparatus and paraphernalia of the craft. For convenience, the test was made after business hours in the early gloom of a winter's evening, and in the half light which struggled

through the grimy windows, the scene was strangely weird. Around the sunken furnace was a little group of interested spectators and as, from time to time, the furnace covers were raised, the white-hot radiance streamed forth on their intent faces, and lighted the whole scene with a dazzling brilliance, strikingly Rembrandtesque in its effect. This, as the magician-in-chief added his materials, and from time to time sprinkled his mysterious powder into the crucible within, rose and fell, changed color and was obscured and modified by dense and curiously colored fumes. Only the wand and flowing robes of the medieval magician were lacking to complete the scene.

The scenic effects were, however, the only satisfactory results of the demonstration. Otherwise it was a striking failure. At the end of the operation the spelter was still spelter, and the magician in charge was merely a warm and perspiring gentleman, much occupied in trying to explain the absence of results. The investigation practically ended there, and the whole matter was dropped. It subsequently transpired that the gentleman had been the victim of his assistant who for purposes of his own not remotely connected with the perquisites of his position, had surreptitiously introduced enough copper into the "home demonstrations" to produce brass.

Another enterprise—the development of an asphalt deposit—was entirely legitimate and well within the scope of ordinary business, but its investigation was rendered difficult by the centralized condition of the industry, the remote location of the deposit, the pe-

culiar features of that deposit, and, generally, by the lack of information on the part of those interested as to how these difficulties might be best met and overcome.

The deposit was located in the Indian Territory, which at that time had not been incorporated in the State of Oklahoma, and any clear reading of its title was difficult. It consisted of an immense perpendicular vein or lead of sandstone impregnated with asphalt. This vein was from 50 to 200 feet wide, went down to an unknown depth, and extended over the country for a mile or so on either side of the point selected for development.

A small plant had been in operation on the deposit but unfortunately had been burned a few weeks before the investigation was undertaken. The deposit itself was developed to a very limited extent, the work consisting of a shaft or pit some fifteen or twenty feet deep with a crosscut of some fifteen feet at the bottom.

At that time, the general asphalt industry was controlled by the Barber Asphalt Company, and almost every competent asphalt expert in the United States was in its employ. Also the various concerns using asphalt were so closely allied, or tied, to the Barber interests that information was not only difficult to get, but when obtained was apt to be absolutely misleading.

The whole matter was further complicated by the fact that the interested parties—who investigated the deposit as promoters with a view to its financing—were ignorant of the asphalt business and worst of all

were short of funds for the preliminary work. As will be seen the conditions were difficult.

The principal points to be decided before the financing of the property could properly be undertaken, were about as follows:

1. What demand was there for asphalt?
2. Was the material of a nature to meet this demand?
3. Was the quantity of crude material sufficient to maintain commercial operations?
4. Could the refined product be produced profitably and on a commercial scale?
5. Was the title good?
6. Could the property be secured on a fair basis?

These points are not, and, of necessity, cannot be arranged in exact logical sequence. They were, however, all vital points, and in a preliminary and superficial way, were investigated simultaneously until, in the opinion of the investigating parties, the balance of probabilities all along the line was sufficiently favorable to justify the expense of a more thorough investigation.

In this preliminary work a discussion of terms with the owners very quickly resulted in an informal, but adequate, written memorandum; a personal inspection of the property convinced the interested parties that the quantity was likely to be more than sufficient; and a discussion of the refining process already used seemed to indicate that some modification of the machinery devised for that process would give a practical method of reduction.

All this was satisfactory, but the matters of demand, or market, and title were more difficult. The title seemed decidedly doubtful and was only passed pending further investigation upon the assurance of the owners—reinforced by the statement of other responsible parties—that the title was the best that could be secured, and that large and valuable coal mines in the general neighborhood had been operated for years under similar titles.

The question of the market for the material could only be settled far enough to show that very large quantities of asphalt were used annually in the United States for paving, varnish, paints and water-proofing and that the price ranged—depending upon the kind and quality of the asphalt and the veracity and imaginative powers of the informants—from \$20 to \$200 and upwards per ton. Any more accurate determination of the matter seemed to involve the investigation of the whole industry, which, while undoubtedly ultimately necessary, was not deemed advisable at this stage of the proceedings.

The results of the preliminary investigation were deemed sufficiently favorable to the property to justify a more searching investigation.

The question of title was then submitted to attorneys versed in the laws and customs of the Territory. These reported that the title—which was in the form of a lease from an Indian Company—was the same as that of other mineral properties being operated in the Territory, and would certainly hold as long as the Indians remained in control; that should the United

States government take charge—as was later the case—some provision would undoubtedly be made to protect titles of the kind, but that even if this were not done, the lease, provided operations were in progress under it, could probably be held under the doctrine of vested rights. This was not satisfactory, but the title was the best that could be had at that time and it was decided to proceed with the matter if the other conditions were favorable.

To determine the question of quantity, a practical geologist of the Southern country was employed, who, after careful investigations and measurements, together with drilling to determine depths, reported that the quantity was amply sufficient to justify a large commercial development of the property. He also expressed his belief that the asphalt was of excellent quality, but not being a specialist in this line his opinion was not decisive.

As no other asphalt of exactly that kind was being mined at the time, the investigation of the cost and method of producing refined asphalt could only be established by the erection of an experimental plant. This was undertaken, a small plant with a daily capacity of about half a ton of refined material being erected on the site of the former works. This plant showed that the asphalt could not be produced profitably on that scale at the prices then obtainable, but gave ample grounds for the belief that with a larger production the cost could easily be reduced to a point at which profits were possible. This plant also gave opportunity for material improvements in the process

and the character of the machinery employed and furnished all necessary samples and material. It also gave the basis for a reasonably reliable estimate of the cost of a larger commercial plant. In this connection many of the other important features were settled such as water and fuel supply, methods of mining, facilities for, and cost of transportation, manner of handling the asphalt, etc.

The determination of the value of the product was by far the most difficult feature of the investigation. The general asphalt industry was in the hands of a strong monopoly, which strenuously resisted invasion of any portion of the field and refused information of any kind, save such as would mislead.

As the simplest practical method of getting at the quality and value of the material, samples were sent to a number of different houses dealing in asphalt and they were asked if the material could be used in their work, and, if so, at what price. Much information was obtained in this way, most of it practically useless. Several houses, dealing in paint and varnishes made from asphaltum, wrote that asphalt such as submitted could not be used in their work. This was literally true but they neglected to add the helpful information that a further simple distillation to remove the superfluous oil would render the asphaltum most valuable for paints and varnish. Another prominent dealer wrote that the samples furnished were about equal to his "D" grade of asphaltum but quite inferior to his "A," "B" and "C" grades and that he thought he might be able to use the product if delivered in New

York at \$15 per ton. As the parties investigating knew nothing about the "A," "B," "C" and "D" grades of the dealer and could not put the refined asphalt down in New York for \$15 per ton, this report was also valueless. Almost invariably the answers were such as to be most discouraging to the investigators.

A general knowledge of the real situation was obtained finally by dint of extended and persistent inquiry. This information came from independent dealers, from the users of asphalt, from experts, or filtered out through the employees or ex-employees of the monopoly. A few asphalt experts were found who were willing to undertake investigations of the material and make at least partial reports, which were reliable as far as they went. Others were willing to give guarded information on special points and all this, in connection with general information gathered from many other different sources, gradually pieced out a reasonably fair, full and accurate knowledge of the whole situation.

The final determination of the matter was that the asphalt was of great purity; much resembled the variety known as "Bermudez"; was quite suitable for paving and roofing, and when refined to the proper point of hardness was excellent for paints and some grades of varnish; that it could be produced at a cost of from \$15 to \$18 per ton, and that its value in moderate quantities would range delivered between \$25 and \$40 per ton according to condition, location, etc.; also that a sufficient demand could be worked up for it at prices that left a satisfactory margin of profit.

All this was ascertained from what was practically the investigation of the undeveloped property, as the little plant actually erected, and the very limited sinking and drifting that was done could hardly be called development. At the conclusion of the investigation, however, the parties having the property in hand were in a position to present their enterprise to capitalists with some grounds for consideration. This was done and after much discouragement and many failures strong and competent parties were found who agreed to take the property up, erect a fair-sized plant and operate it on prescribed terms. These terms were reasonable and the arrangement would have been consummated but for an unfortunate disagreement among the parties controlling the property. This effectually tied up the whole enterprise, the little plant was shortly after burned a second time, and the property remained for years unworked, deserted and in a condition of melancholy desolation. Later it passed from the control of the original lessors, the property was more fully investigated, oil was discovered, and it is now looked upon as one of the most valuable mineral properties in that part of Oklahoma.

The great difficulty in the development of this property lay in the very effective opposition of the monopoly which then practically controlled the asphalt business of the country. In an ordinary enterprise this difficulty would not be encountered. Expert assistance, as a rule, can be obtained with the certainty of full and reliable reports, the general conditions may be easily

ascertained by direct investigation, and, where necessary, working tests can usually be made with but little trouble or expense.

As an illustration of this latter class of enterprise, the contemplated development of a silicate clay deposit near Pittsburgh may be briefly considered.

This bed lies in the side of a low bluff almost abutting on the railroad track and consists of an upper decomposed clay, covering a lower and much harder siliceous clay that must be removed by quarrying. The upper clay is supposed to be adapted to the manufacture of the ordinary fire brick, the lower hard clay to the manufacture of the very refractory fire brick required in the furnaces of the iron and coke regions. The title to the property is unquestioned, it can be obtained on reasonable terms, the quantity is practically decided to be sufficient by the location and general character of the beds, the demand for the brick is reasonably large and constant at a known and steady price, and transportation is at hand at a fixed rate. The only important points left for investigation before the value or possibilities of the enterprise may be reasonably well determined, are (1) the suitability of the clay, (2) the quality of the product, and (3) the cost of production.

The nature and value of the clay can be easily and cheaply settled by sending a sufficient quantity of the material to brick-yards which are near at hand, where it may be worked, molded and burned with the apparatus and equipment there in use. If these near-by brick-yards decline to assist in the establishment of a

possible competitor, more distant brick-yards must be resorted to where an actual trial may be made at a still very moderate total cost. In either case, a practical working test of the clay is secured that determines its behavior and the character of its product under conditions that hardly permit of error.

In addition to this, however, the nature of the clay and its products may also be determined—and should be determined—by expert investigation and analysis. In this way the exact composition of the clay may be ascertained, and as the requisites of a good fire clay are well known, the value of the particular clay for this purpose may be decided almost as positively as by a working test. There is no difficulty in finding competent analytical chemists who make a specialty of such work, and their reports can be relied upon.

The general value of the finished brick might be determined by an extended practical test but may also be ascertained—and almost or quite as certainly—by this same expert analysis, or, more properly speaking, investigation. By actual trials the expert can decide with exactness on the strength of the brick, its durability, resistance to fire heat and the other details of importance in this connection.

The nature of the clay and the quality of the product having been settled, there remains only the cost of production and the cost of marketing to be considered. The production cost may be easily determined. Unless special difficulties are encountered in the particular clay, the cost of manufacture after the clay is taken from the earth is a matter already well known.

Special difficulties in the clay are not likely to be encountered, but if they are, should be detected both by the actual trials and by the expert examination. If they are found, the cost of manufacture—if materially increased by these difficulties—should be determined by working tests on a large scale at neighboring brick-yards.

Granting that no special difficulties are discovered, the only items in the production cost still undetermined are the expenses of digging or quarrying and any expenses of handling due to the particular location, the local cost of fuel and labor being already well known. The quarrying costs may be determined by expert estimate and be verified by actual experiment. The after handling may also be estimated by an expert with quite sufficient accuracy, as the whole matter is one of general knowledge in the industry.

In this case every point requiring investigation may be decided to a nicety in advance, and if the results are favorable and the prime essential of good management can be secured, the enterprise should be almost certainly successful.

An undertaking of this general nature may, however, be greatly complicated by the introduction of new and more or less uncertain elements, such as a proposition to employ new and untested machinery, or to manufacture brick for street paving when the clay is untried and the qualities of the brick produced may only be determined satisfactorily by extended tests, or for the production of a new facing brick of a

unique form, or of an unusual color, the popularity of which can only be determined by actual experiment. A brick "proposition" bringing in some of these disturbing features is discussed in the succeeding chapter.

CHAPTER X

INVESTIGATION OF A SPECULATIVE ENTERPRISE.

As has been stated, in the more speculative enterprises such as many mining propositions and inventions in their earlier stages, accurate determination of the value of the undertaking is impossible in advance of development. As a consequence, such enterprises usually involve a very large measure of risk.

The investigation of an enterprise of this kind can only approximate the possibilities. If the facts determined are such as to justify the development of the enterprise, it should be a success. If not, the enterprise is reasonably certain to be a failure.

Some of these speculative enterprises are so utterly indeterminate as to value and so far removed from any ordinary business operations, that they can only be looked upon as gambling. Others of a necessarily speculative nature are entirely legitimate, the risks while great being justified by the ends to be attained and the profits of success. It may be noted that—outside of manipulated operations or enterprises—it is usually from these speculative ventures that the sudden and dazzlingly brilliant rewards of the business world are obtained.

The two great fields of speculative enterprises are

mining and invention. In these modern days, however, science has seized upon the field of mining and has eliminated much of its speculative attraction. "Grub-staking," unexpected strikes, and marvelous developments aided by imagination and credulity still serve to keep up speculative activity, but as a rule an intelligent man desiring to engage in legitimate mining—save as a prospector or a small investor—secures the services of an expert and goes in on a strictly business basis. The general geological formation is noted, conditions in surrounding mines are investigated, the particular mine or prospect is carefully studied, its possibilities are, by expert premonition and a diamond drill, traced out and mapped, and the whole business is brought down to the basis of a prosaic system.

The field of invention is, however, still untouched by the cold hand of science. Here the trained expert is not in control. He cannot block out the inventor's brain and announce the values in sight. He cannot even make a reliable prediction as to what will be accomplished by the inventor, or, save in the most obvious of cases, by his invention. Whenever the design is unique or conditions are new, the best of machinists or mechanical engineers can do but little more than guess,—and sometimes not even guess intelligently.

For instance, who could foretell the future of the telephone? Here the design and the purposes were so entirely beyond all experience that the estimates of its value were absolutely divergent. Even among

those best qualified to judge, the opinion was very freely expressed that it would never come into general commercial use. It is doubtful if any, even of its friends, foresaw in it one of the common necessities of business and social life. The objections urged against it,—that it would be a nuisance in the office, that messenger and office boys were entirely adequate as a means of communication, and that generally the idea was visionary—are familiar to us all. Not even the experts were anxious to invest in the new enterprise in which every dollar has since increased a thousandfold.

Take another instance, along the same general lines but with a different termination,—that very interesting invention, the phonograph. Here, from the first, a strong impression prevailed—which it may be said, ought to have been realized—that the invention had a brilliant and immediately profitable future before it. The history of the telephone was to be repeated and there was a rush of investors, both experts and ordinary people, to reap the rich harvest. History was repeated but it was not the history of the telephone. The first attempts to introduce the phonograph were practically failures and the majority of the original investors lost every dollar of their investments.

In this case the promoters of the enterprise believed, and not without reason, that the phonograph and the related device, the graphophone, had a most extensive and valuable field in the business world. They were to be used in the office as an assistant to, or substitute for the stenographer. The idea was apparently sound

and so thoroughly were the promoters of the invention convinced of its correctness that in the earlier history of the undertaking they actually discountenanced the use of the machine for purposes of amusement on the ground that such use would belittle it and would retard its introduction in its best and most profitable field,—the business office. For some reason, however, the machine did not take with business men,—probably because it was not as well adapted to their use as it could and should have been. Be this as it may, as a business machine the invention was a dismal failure. A few lingered in offices here and there to show that there was some virtue in their commercial application, and the effort for their introduction into business was later taken up again with considerable success, but the great and profitable use of the phonograph, the graphophone and the later related machines, has proved to be as a means of diversion. It is in this line that the few of the original investors who really profited by their connection with the phonograph and its kindred machines have made their money.

While all this is entirely true, it does not follow that investigation can be dispensed with in the field of invention. On the contrary, it should be more rigid here than in almost any other kind of enterprise. Every feature of uncertainty should be removed as far as possible, so as to reduce the risk to its lowest and clearest terms.

It may be noted in passing that the estimates of the inventor himself are but rarely reliable, and are to be accepted not at all, or with much caution—not neces-

sarily because of any intention to deceive on his part but from the nature of the case. An inventor is of necessity an optimist. A pessimist does not have the courage of invention. The inventor then, an optimist to begin with, ignoring adverse conditions, ever on the look-out for favorable indications, watchful for facts that coincide with his theories, oblivious of those that do not, staking his time, his money and his efforts on the successful outcome of his design and of its value when perfected, is, to say the least, not an unbiased judge either of the merits or value of his invention. His opinion may be useful but it should only be taken with these conditions clearly in mind.

It is, of course, always possible, though very far from probable, that a proposed mechanism will do all that its inventor claims for it. It is also possible that it may prove so entirely new in operation and unique in construction, that patent protection is merely a matter of application. All this may be true, but it must be remembered that even Solomon—who was quite willing to take chances on occasion—expressed doubts as to the absolute novelty of anything, and his father, David, in a somewhat hasty generalization, intimated that false representation is common to all men. As a matter of fact, to venture money on the unsupported anticipations of inventors is even more reckless than “bucking the tiger,” speculating in bucket shops, or cornering wheat.

An illustration of the results likely to follow any such unguarded investments is afforded by the history of a company organized some years since for the man-

ufacture of brick. This company based its very liberal expectations of profit on the merits of a newly invented and somewhat extraordinary apparatus. As conservatively estimated by the inventor, this mechanism—or to be more accurate, this train of mechanisms—was to mould, deliver and bake ordinary building brick of fair average quality at the astonishing rate of not less than 525,000 each day. The net profits of the company on this operation—as figured by the inventor—were to be at least \$5 on each thousand of brick, giving a total daily profit net on each and every machine of not less than \$2,625.

If the mechanism had been properly tested and demonstrated, these estimates would indeed have been impressive. As a matter of fact, however, no investigation of any kind had been made by either the inventor or his associates. The mechanism itself then existed only in the form of neat designs on tracing paper, and, with a fine disregard of ordinary business procedure, patents had been practically ignored. Apparently the inventor reasoned that the mechanism, having been invented by him, could not fail to operate in accordance with his intent, and that for equally good reasons it would undoubtedly receive the fullest measure of patent protection whenever he found time to make application.

At any rate, acting upon some such belief and armed only with his designs and a large brick which he used for purposes of demonstration, the inventor attacked a credulous public successfully,—so successfully that without further investigation than an inspection of the

inventor's brick and a consideration of his statements, over \$10,000 in cash was placed in his hands for immediate expenditure. This was followed by further subscriptions until over \$30,000 was staked on the success of the somewhat mythical machine.

At this point it occurred to a prospective investor that it might be wise to investigate the inventor's claims and the protection of the mechanism. He discovered the real conditions. These were made public and had the effect of practically killing the whole undertaking. Subscriptions ceased and shortly thereafter the company lapsed into a permanent condition of innocuous desuetude.

The investment of money in the instance just cited, was reckless to a surprising degree. It might, however, have been fully justified if it had been first devoted to the investigation of the mechanism and then to its proper protection and development. Most inventions do require money to perfect them and large sums are frequently and necessarily expended for the purpose. Such security was felt, however, as to the operation and due patent protection of the mechanism whenever the inventor found time to attend to these matters, that the major portion of the funds subscribed were expended in the testing and leasing of convenient clay beds, the erection of docks, kilns and buildings, and a thousand and one things necessary for the general business of a brick company; the construction of the apparatus meanwhile awaiting the completion of the setting in which it was finally to blaze forth in splendor.

In this case it is to be noted that the inventor was

apparently honest in his belief and statements. This was, however, no reason for omitting ordinary precautions. On the contrary, a most rigid investigation should have been conducted and this should have been devoted mainly to the machine itself. The general condition of the brick industry was too well known to require special investigation and this might properly have been omitted. In fact everything else should have been subordinated for the time being to the investigation of the proposed mechanism.

The first step should have been an investigation as to patents. This whole matter might have been safely left in the hands of the patent attorneys, and if their report showed that the mechanism was patentable and that no serious conflicting patents or claims existed, the construction of a demonstrating machine might have been begun with reasonable safety. At the same time patent applications should have been filed. It is possible that prior and conflicting applications might then be encountered in the patent office which—as applications for patents are not open to examination—could not have been discovered before, or be drawn out in any way save by means of the patent application. If serious conflicts developed in the patent office the construction work on the machinery would, of course, be suspended until these conflicts were overcome.

The scale of construction work would depend largely on circumstances. It is discussed at some length in the succeeding chapter. Speaking generally, good business policy dictates the smallest mechanism that

will give a practical test. It is probable in the case of the brick machine that a full-sized construction would have been required. It is also probable, however, that this construction need only have covered the critical parts of the mechanism—that is, the parts that were different from other existing machines.

While under construction the brick machine might from time to time have been tested with clay brought in for the purpose. Such testing would probably be sufficient to prove the principles involved and, if the results were satisfactory, justify the construction of a more complete machine on an operating scale. Should there, however, be any lingering doubts as to the practical working of the machine, the matter might have been settled by installing the model in some brick-yard and allowing it to be operated there for such length of time as necessary. Such practical test might have to be paid for, but usually could be secured without further expense than the installation of the machine.

Usually long before the completion of the working model, patents would have been granted, or so many claims allowed that these public trials could be safely made.

As soon as the machine was thoroughly tested and its patents secured, the whole nature of the enterprise would be changed. The speculative or uncertain elements would be removed and the enterprise be brought to the basis of an ordinary business risk. With a demonstrated machine, capable of producing good brick at a cost materially below that of the present machines, the enterprise would become both safe and

attractive and would justify the investment of almost any reasonable amount of money for development and operation.

The proper investigation of mechanical patents and patentable devices, and the determination of their values, as nearly as may be, is frequently a matter of much difficulty. Many uncertain elements are usually involved, depending to some extent upon the point which the inventor has attained before the investigation is begun.

Sometimes and not infrequently an invention of this kind will exist only in the brain of the inventor or in more or less crude sketches. Sometimes he will have constructed a small working model of the device or of its essential features. Sometimes his patents will have been secured. Occasionally he will have gone still further and have constructed a working machine on a commercial scale. The method of investigation will be governed largely by the conditions which exist.

When the invention has merely reached the stage of the design more or less completely worked out by the inventor, or even if a model has been constructed, the first enquiry is usually as to the general value of the device. Perhaps enquiries as to its patentability might be instituted at the same time. Modified by the conditions of any special case, these enquiries would be about as follows:

- (1) Is there a demand for the invention or its output?
- (2) Will the invention do the work?

(3) Will it do it better or cheaper than other existing devices?

(4) Can it be efficiently protected?

(5) Are the values determined by the preceding enquiries sufficient to justify the undertaking?

Where the invention is of a standard machine such as a typewriter, a reaper, or some mechanism to produce a standard product such as a loom or a brush-making machine, this first question of demand may be passed without investigation. It is obviously sufficient, provided the new machine possesses merit enough to control its fair share of the market.

On the other hand, where the device is obviously unnecessary or impractical as are so many of the inventions that crowd the pages of the patent office reports, the matter will end with this first query. Thus in a "non-refillable" bottle patented some time since, a cartridge or small bomb is to be inserted with the cork in such a manner as to explode and blow the neck of the bottle to fragments when the cork is drawn. The device would undoubtedly prevent the further use of the bottle but does not seem to have met with a popular demand.

Instances of inventions that are equally impractical or useless are numerous, but the records are also full of mechanisms for purposes sufficiently useful in themselves but that could not possibly work on any known mechanical principles, or for useful mechanisms that might be made to work but that would be inferior to other mechanisms already in operation.

Further there may be inventions in which the design

itself is so unique or the conditions under which it is used are so different from those usually existing, that the estimate of its demand and consequent value can, at the best, be little more than intelligent guessing. The telephone, phonograph and wireless telegraphy, already instanced, are cases in point.

Generally, however, inventions are sufficiently well within the boundaries of ordinary conditions to permit of a fairly intelligent estimate of their probable demand and of their general value if successful. As will be readily understood, an estimate of this kind is not intended to be final, and in practice is frequently far from accurate. It is merely to show roughly whether a demand exists or can be created, sufficient to justify the further investigation of the device. In many cases, however, this preliminary determination of the demand will be so accurate or so satisfactory as to be final. In other cases the matter must be considered later in connection with other features of the invention, before a satisfactory determination can be reached.

If the demand for the invention is decided in its favor, or must be deferred for later investigation the next point concerns its efficiency. Will it do the work, and will it do the work better than other devices or has it special points in which it excels? If it cannot meet the competition of existing devices, it is obviously barred. The puzzling feature here is frequently found in the fact that a new mechanism will probably do the work better in some respects than existing mechanisms but no better or possibly not as well in other respects.

Then the probabilities must be balanced to determine the prospects of success.

If the mechanism will do the work as well as existing devices and the demand for such mechanism is large, and particularly in the field of standard machinery such as the typewriter, the sewing machine, the printing press, etc., the new device may have a considerable future before it in spite of its lack of special excellence. Ordinarily, however, the new mechanism should be capable at least of doing the work better in some special direction, if any large measure of success is to be attained. A cheaper construction enabling it to undersell competitors, or a stronger structure enabling it to outlast them, or some excellence of output, or it may be a general excellence of construction and work,—something of the kind should exist to justify the entrance of a new competitor into an already well-filled field.

It is obvious, then, that the second and third queries are involved when the matter of competition enters in and must be determined before the first query can be finally answered. The new invention must not only work, but must work as well or better than mechanisms already in the field or there will be no demand for it or its output.

In the majority of cases these points can only be settled by the construction of a model or experimental machinery. There are cases where the principles involved in an invention are so clear or so simple, or the mechanism employed so familiar, that its value is obvious, but when this is not the case even experts

will differ as to the operation of a new device and as a rule nothing demonstrates the practicability of a new invention as well as an actual trial.

The writer recalls an instance in point. Here the inventor and his machinist, who was then engaged in the construction of a model, were at direct variance as to the practicability of a simple though important element of the mechanism. The inventor stoutly asserted that it would work as designed; the machinist as stoutly declared that it would not and could not, being contrary to the laws of mechanics. The inventor insisted that the construction be proceeded with, which was grudgingly done. The apparatus worked and the machinist had to readjust his conception of the laws of mechanics, but the matter could not well have been decided without an absolute demonstration. The general subject of model-making is discussed in the succeeding chapter.

The investigation of patents will probably have proceeded simultaneously with the general investigation of the invention. Here the investigator unskilled in patent matters can do but little himself and the research involved must be entrusted to attorneys versed in patent affairs. An investment of \$5 to \$10 with some capable patent lawyer will usually secure a search for conflicting patents and a fairly reliable opinion as to the patentability of an invention. Also not infrequently the same lawyer—having patent applications in view—will, without additional charge, give an expert opinion as to the general merits and value of the particular invention.

The search to determine whether the device may be patented, will bring to light any other similar inventions already patented which may, in whole or in part, conflict with the invention under consideration, and which may therefore prevent its full protection by patent. Occasionally on such a search a supposedly new invention is found to be absolutely barred from patents by these prior patented inventions. In any such case the invention must be dropped unless it can be modified in some way to avoid the claims of the existing patents, or unless some arrangement can be made for the use of these other patents. Also when applications for patents are made, other pending applications for similar devices, or for devices conflicting in part, may be discovered. Then, unless these interferences are decided in its favor, the invention is again barred in whole or in part.

Usually, however, even if conflicting patents or applications exist, other features will be found in the new invention that do not conflict, and these may be secured either for independent use or for use in connection with the conflicting device or devices. In such case, however, the value of the invention is very seriously lessened. In fact it is but a portion of the undertaking as originally contemplated.

It is also to be remembered that even though conflicting applications exist, the new invention may establish a superior right and defeat the opposing claims, or if the invention is barred from patent protection as to some of its parts by prior patents, the features which are patentable may, as suggested in the pre-

ceding paragraph, be of value and well worth securing, and also if barred by prior patents which have expired, the invention might still be operated without patent protection on these special features. It might even be operated without patent protection of any kind. It would then simply enter the field in an open competition, the best device to win.

In most cases, however, in an investigation of an invention, it is found to be patentable in whole or to such a degree as to make its development worth while, if the other features are sufficiently in its favor, and in that case the general consideration of the enterprise is in order.

At this stage of the investigation the demand for the new device, or its output, its operative value and its patentability will all have been determined as accurately as the conditions will permit. The material facts as far as these may be secured, are before the interested parties and they must then determine whether the enterprise shall be abandoned or shall be pushed on to industrial operation with its resulting success or failure.

In many cases the information on which action must be based is, of necessity, woefully insufficient. The action must nevertheless be taken, but will lack the sound foundation usually desirable in commercial undertakings. The enterprise if taken up, is then a speculative one, with great risks and, presumably, compensating rewards in event of success.

CHAPTER XI.

EXPERIMENTAL WORK AND MODEL-MAKING.

In some few cases the practicability of an invention can be determined from existing mechanisms, or when the device is very simple, from the general principles upon which the mechanism is to operate. Usually, however, a model or an experimental construction will be found necessary.

It is but seldom that this model or construction work is completed on the lines first laid down or at the estimated cost. Almost invariably something defective is found that must be remedied, or an improvement occurs to the inventor, or some change in the general design is found advisable. Even when the model is built on the lines of the first plans, it is usually the case that the workmen take more time than was expected, or that a higher grade of workmanship is required, or that more expensive material must be used, or that incidentals come in that were not at first included. Because of this, the construction cost of models and experimental machines has an alarming tendency to soar far beyond the estimates and the expectations of the interested parties, and in undertaking any work of the kind a liberal margin for unexpected expense and modifications of the original design should always be allowed.

The writer recalls an instance in his own experience where the whole cost of a small apparatus was estimated by the machinist at between \$100 and \$200. The work was started, the most doubtful element of the mechanism being taken up first. Before this one feature was worked out, the expenditures had run up to \$125 and the main portion of the machine had not been touched. At that time the estimated cost of the remaining work—revised in the light of the experience already gained—called for some \$500 more. There were no material changes in the design nor were there any improper charges. The excessive cost was caused almost entirely by the greater difficulties and the much more detailed work found necessary in actual construction than was considered requisite when the estimates were made.

It should be noted, however, that occasionally an unscrupulous machinist, with full knowledge of the fact, will give an original estimate entirely insufficient for the proposed mechanism. He does this for the purpose of making a first attractive figure that will secure the work, feeling sure that if the inventor once begins, he will not give up even though the cost does run far beyond the estimate. The practice is to be guarded against. It not only savors of dishonesty and is in itself a good reason for avoiding the particular machinist, but its operation is apt to be very disconcerting when funds for experimental work are limited.

The usual arrangement for experimental work and

model-making is a charge for the time and material required, the time charges ranging from 50c. to 80c. an hour, or even higher, according to the conditions and the skill of the machinist. Materials are supposedly paid for at cost.

This arrangement usually works well. Occasionally, it is true, machinists are found who take advantage of the situation and charge up time, material and incidental expenses improperly. It is very difficult and frequently impossible to dispute such charges and the only satisfactory course in such a case is to transfer the work to another and more reliable machinist. Before this is done, however, and before any suspicions are seriously entertained, a very careful investigation of the particular matter should be made. Charges which are entirely proper have a way of mounting up that is most surprising to those not familiar with the uncertainties and vexations of experimental work. Usually when fraud is charged in matters of this kind, the unexpected cost is merely an incident of the work that would have been anticipated by one conversant with model-making.

Experimental work is sometimes, though rarely, taken under contract by the machinist at a fixed total cost. The plan is not satisfactory. Such a contract cannot well cover changes in the original design, or guarantee its successful operation, or call for anything further than the construction of the machine in accordance with the designs as submitted to the machinist. If modifications are necessary, if new ideas are brought

in or materials are changed, it is at the expense of the party for whom the work is being done and all this opens a wide door for excessive cost, dissatisfaction and disagreement. Also, as a matter of ordinary prudence the machinist must charge a sufficient margin over his estimated cost to cover all possibilities, and as he is very fully aware of the uncertainties of experimental work, this allowance will usually be far beyond the actual cost,—so much so that there would be a distinct saving in having the work done under the usual arrangement.

As a rule, the smaller shops, if their facilities are at all adequate, are to be preferred to the larger establishments for experimental work. The larger shops are generally much better equipped but any particular job does not, as a rule, receive the same individual attention from the skilled machinists of the establishment as in the smaller shops, and waste of both time and material is much more likely to occur. It must be said, however, that there are exceptions to this rule where both better attention and more economical work are secured in the larger establishments.

When funds are limited and experimental work is to be undertaken, a trustworthy machinist should be selected, the matter be laid before him fully and his advice taken as to the best course to pursue. Frequently it is possible by the construction of a few of the new or more essential features of the device to prove the principles involved, and to thereby gain all the advantages of a demonstration with but a fraction

of the expense involved in the construction of a complete machine.

In the demonstration of any complex apparatus, provision is always made for heavy expenditures in experimental work. If a new typewriter is to be brought out, an allowance, according to the complexity of the machine, of from \$25,000 to \$100,000 for experimental work and the construction of machinery for the manufacture of its parts, is considered reasonable. One of the simpler typewriters could undoubtedly be worked out at a very much less cost, but it may be safely stated that no one of the standard typewriters has cost less for experimental work and machinery for the manufacture of its parts, than the larger amount mentioned. Most of them have cost more. The estimated cost for working out a type-setting machine runs even higher. As stated in the American Dictionary of Printing and Bookmaking, "almost any type-setting machine will require the expenditure of from forty to eighty thousand dollars before any printer will be found bold enough to make a trial of it in his office, and as much more before it is reasonably perfect." The Paige type-setting machine, referred to in Chapter VIII, cost over two hundred thousand dollars, and was not then a practical machine.

On the other hand, models of small or simple mechanisms, or perhaps parts of these mechanisms, are frequently made at an expense of a few dollars. In many cases the inventor himself is able to construct the working model, thus avoiding most of the expense of ex-

perimental work. Occasionally a device is so simple and so obvious as to require no work of the kind.

As a general rule, experimental work and model-making should be on the smallest scale that will satisfactorily demonstrate the mechanism. While this is true, it must always be borne in mind that the operations of a small machine may be misleading. Roughnesses or uncertainties of operation that seem of but little importance in a small machine may be emphasized into fatal defects in a larger machine, and connected features that hardly enter into consideration of the small machine may become so essential in the operation of the larger machine as to destroy its practical utility.

For the reasons mentioned or sometimes because of the nature of the mechanism, construction must at times be on an operating scale from the first, but the general rule still holds that in developing or investigating a mechanical invention the first construction should be the smallest and cheapest that will give a real test of the principles and the mechanism involved. It is almost inevitable that the new device will require many changes of the first design, and will show many possibilities of improvement before its working form is achieved, and most of this can be secured by the construction and operation of the first small model. Then after the principles and operations of the new device have been demonstrated and the best method of construction has been determined, this first apparatus may be "scrapped" if necessary, and an operating machine be built.

This rule is one frequently violated. Inventors

are prone to over-confidence, and are often so sure of the operation of their untried inventions that they insist on full-sized models. Sometimes this is wise but in most cases it is reckless extravagance. The writer has in mind an improvement in printing presses whereby the whole character of the present press was to be changed. The plan looked plausible. Hand tests showed excellent results. It was then proposed that a small working model should be constructed at the expense of a few hundred dollars to prove the correctness of the principle. The inventor, however, insisted that the principle had been proven by the hand tests and that a full-sized cylinder press should be purchased and adapted to the new mechanism. The press was bought, the upper works were taken off, the bed planed down, the new attachments constructed and put in place, and the machine was ready for operation. The result was an absolute failure, at a total cost of some \$2,000. Not only was this unnecessary expense incurred, but the writer believed then and still believes that the general principle was correct and that if it had been worked out on a small scale with the numerous experiments and changes of mechanism then possible, the invention might have been brought to a successful and most profitable issue.

Another somewhat similar instance was the construction of an apparatus designed to compress the walls of brass cylinders, the pressure required being peculiar and difficult to secure. Several plans were suggested but the inventor finally decided on a piston or plunger coming down into a steel cylinder, the brass cylinder being first fitted into the steel cylinder so that

when the piston came down the brass would be compressed between the piston head and the walls of this cylinder. The idea struck the inventor so favorably that he decided a full-sized working machine should be made at once. The machine was accordingly constructed with a height of some forty feet and a cost of \$8,000. When completed the apparatus was tried and found to compress the brass cylinder very successfully but the piston wedged so firmly whenever it came down that a hydraulic press was necessary to force it up again. As such an arrangement was impractical, the whole device was abandoned for a simpler method and was a total loss except as junk. The result should have been attained at an expense of a few hundred dollars.

Another instance that perhaps illustrates this point is found at the little town of Edison, which for a number of years played the role of the deserted village in a remote spot in New Jersey. Here an enormous and costly plant was erected for the reduction of the low grade iron ores which are found in quantity in the neighborhood. The process used was an untried one, devised by the noted inventor after whom the town was named, and involved a number of novel features, requiring the construction of new and—as worked out at Edison—enormously expensive mechanisms.

The scale of the whole undertaking was magnificent. A town for the accommodation of the workmen was erected around the works. A special railroad was built to the place with a neat station and freight house. An electric light plant was installed

for use in the works and to supply the town. A post-office, stores, a school-house and church were erected. The works themselves were among the largest in the country, covering many acres of ground, and at the time they were in operation contained some of the most ponderous mechanisms ever constructed.

Everything necessary, or supposed to be necessary, was installed with a striking disregard of expense, but the undertaking could not be brought to a commercial success and the works were closed. At the present time the place is dismantled. The costly machinery has been sold for scrap iron, the immense buildings have gone to ruin, most of the houses have been removed, the mine is a vast pit of water, and a general air of rust and failure pervades the entire country side.

It may be said that in this case the interested parties claim that the process was a success and that the apparent failure was caused by the opening of the immense iron deposits of the lake regions and the introduction of processes by which the production cost of this competing iron was greatly reduced. Be this as it may, the fact remains that between five and ten million dollars were expended without any visible results save vast and rapidly wasting ruins, and while there may have been reasons that warranted this tremendous expenditure, it seems hardly possible that the process could not have been tested on a smaller scale and at a mere fraction of the cost actually incurred. Apparently it was experimental work on a gigantic and unreasonable scale.

PART III. PROTECTION OF AN ENTERPRISE.

CHAPTER XII.

PATENTS.

An eminent commander of the Civil War, abundantly qualified to express an opinion, is credited with the terse but forceful conclusion, "War is hell." The general correctness of the position is popularly admitted. It is also admitted that industrial competition is a form of war.

The reason for the clean-cut separation that usually exists between the private and the commercial life of the man of business, is not clearly apparent. Just why the kindly, helpful and considerate gentleman of home life should by the brief transition to his office, be converted into a business barbarian, of distinctly predatory habits, hard, unscrupulous and commercially cruel, is one of the anomalies of modern civilization, difficult to explain.

All that can be said is that such is the state of the case and such the nature of the game as it is played. Possibly it gives zest to life. Be this as it may, as most of us have to play, we should, even if we do not choose to be commercial savages, play with a clear

recognition of the conditions that prevail. Under these, the proper protection of a business or enterprise becomes of paramount importance. We must hold what we have by every means at our command. The better the protection, the more safely and the more satisfactorily may we go forth to wage commercial warfare with the outside barbarians.

Enterprises are protected by different methods, determined by the nature of the particular enterprise and the conditions by which it is surrounded. For mechanical inventions, and the devices and processes with which it is possible, the patent is generally relied upon and will be first considered.

A patent is formal evidence that officials of the general government, duly appointed thereto, have examined the papers submitted by the applicant; that, as far as they were able to ascertain, there were no conflicting claims superior to those of the patent claims allowed; that as there appeared no good reason for not so doing, they issued the patent in question, and that by reason of such issue and so long as nothing occurs to prevent, the party to whom such patent is issued has the sole and exclusive right to make, use and sell the invention covered thereby and to authorize others so to do, for the life of the patent and for any extensions thereof.

This is all the Government undertakes when a patent is issued. It does not in any way guarantee the patent. Nor is the patent by any means nor in any way a final and complete title, nor is it so regarded—unless so fundamental or unique in its claims as

to have no opposition—until it has been fully passed upon in the courts. It is a conditional title to the invention, a sort of a quit claim deed. It is a certificate that the owner has the best title known to the Government officials and that he is authorized to hold possession of the invention for the life of his patent unless someone comes along sooner with a better title—or possibly a better lawyer—and ousts him therefrom. It is a tentative title that may perhaps never be questioned, but that is always open to investigation and attack by anyone who has, or thinks he has a superior title.

This may seem a somewhat extreme view but it is literally correct. Whether it is the best way to issue patents is another question. It is the way they are issued in this country and this must always be taken into account when protection is sought through patents, or when patents are bought or are taken as valuable assets, or when they form part of an enterprise. That is, a patent is a very desirable thing to have and, in perhaps most cases, is sufficient, but it is always liable to be attacked, and, until adjudication, to be overthrown, and for this reason as well as on grounds of general prudence and safety, not only should the patent itself be strengthened in every possible way, but no other means should be neglected for the fortification and protection of the enterprise which is based upon this patent.

The present volume is not intended as a manual of patent practice, but it may be briefly said that the usual procedure is first the selection of a patent solic-

itor; then a preliminary search of the patents already issued to make sure that the invention is not barred out by existing patents; next, if the preliminary examination has shown no serious obstacles, the preparation and filing of the patent application, or applications.

It is taken for granted that a patent solicitor will be employed. Theoretically, an attorney is not absolutely essential. The inventor may obtain a copy of the rules and procedure of the patent office containing forms and suggestions and prepare and file his own application. Occasionally this is done, but the somewhat caustic remark that a man who is his own lawyer has a fool for his client, is then usually applicable. The patent officials do not smooth the way for such applicants. They have sufficient occupation without unraveling the complexities of amateur patent applications. Generally such papers are returned time after time for correction of the numerous defects and deficiencies characteristic of such documents, until the applicant wearies of his task, or concludes that the patent office is in league with the patent attorneys, or perhaps realizes the true condition that the matter is one requiring expert attention and that he not being an expert, cannot draw the papers properly, and therefore goes, as he should have done at first, to a patent attorney.

Where the invention to be protected is of any material value, the only possible excuse for an amateur application is the absolute inability to pay an attorney's fees, and these latter are usually so moderate—

or will be made so, if the position is explained—that the inventor would do better to devote his time to raising these fees, than to be wasting it upon the application.

If an amateur application is finally worked through, the resulting patent is viewed with suspicion by all intelligent investors. So true is this and so closely is the scope and validity of a patent dependent upon the knowledge and skill with which it is drawn, that the mere fact that a first-class and reputable patent attorney had charge of the application is a direct and material addition to the strength and value of the patent, and later to that of the enterprise founded upon such patent.

The attorney's charges for a patent application range from a modest fee of \$25, far upward into the thousands, according to the complexity of the case. No reputable attorney objects to fixing a definite figure for any particular application, or, if this cannot be done, to giving a pretty close approximation of what it will cost. When expenditures must be kept within certain limits, this cost should always be determined before the case is put into the patent attorney's hands.

In regard to the selection of the patent solicitor or attorney, it may be said that most, if not all of the regular patent attorneys of the country are reliable, and, usually, competent. Of those solicitors whose somewhat extravagant claims are advertised so widely and of many of the patent agencies, such unqualified endorsement cannot be given. Probably most of these

are fairly reliable; some of them have gained most desirable reputations by long years of first-class work, but, in many cases, it is to be feared that the welfare of clients is not always their strongest actuating motive.

It is but rarely, if ever, that either attorneys or agencies will improperly disclose inventions confided to their care. Such a proceeding, or even a suspicion thereof, would effectually end the career of any offending institution or attorney. There is some danger, however, if an agency or an attorney of unknown or questionable qualifications is employed, that the applicant will not be advised to the best advantage, or that the patent applications will not be drawn to secure all that might be had, or that they will not be properly pushed when drawn. In short, as a rule, a patent taken out by a regular patent attorney is regarded as preferable to one taken out by one of the agencies or an advertising solicitor of patents. These latter, even if qualified, usually handle such a mass of business that they cannot do the same good work as does the attorney who gives the application his individual attention and whose personal reputation is supposedly at stake.

It is not to be understood that either patent attorneys or agencies, whether of standing or otherwise, are conducting philanthropic institutions for the benefit of inventors, but it is a fact that the services received usually extend much further than the mere application for a patent. If the attorney is a reputable one, the best interests of his client come before fees,

both as a matter of professional ethics and as a measure of good policy. He will advise his client as to what patent or patents are desirable, as to the probability of securing these patents, as to the best method of procedure, and endeavor to secure the most efficient protection with the least expenditure. He will frequently go further and give an opinion as to the merits and salability of the patent itself, which while unprofessional, is nevertheless expert and valuable.

In regard to the personal relations between the inventor and his patent attorney, it may be said that the attorney is usually entirely willing to explain to the inventor any points of procedure that are not quite clear to the latter, and is glad to discuss in detail the invention to be patented. The inventor has presumably a knowledge of the difficulties overcome, a keen perception of the excellencies of his own invention, and an insight into the special points that should be covered, that even an expert patent attorney cannot obtain in the comparatively short time devoted to that individual application. Hence, the inventor's assistance is valuable and desired.

The inventor must, however, remember that the attorney's time is one of his most important assets and that it should not be wasted in unnecessary criticism or untimely discussion. It is usually difficult for the inventor to realize this fact. His invention is so valuable and of such absorbing interest to him that he forgets the many other demands upon the time and attention of a busy patent attorney, and, after some unduly prolonged discussion, ascribes the impatience

of this latter to indifference, when it is really caused by anxiety as to his other neglected work.

The preliminary search or examination to determine whether an invention or any of its features have been already patented, is in most cases a very simple and inexpensive matter, costing from \$5 to \$10, and in a well-equipped office requiring but a day or two, or even less time, to complete. In more complicated cases, the cost may run up to very much larger figures, depending entirely upon the amount and difficulty of the work involved.

The general patentability of the device will probably have been passed upon by the patent attorney before this preliminary search is undertaken, and the only fact established thereby is—when such is the case—that there are no obvious conflicts in existing patents to stand in the way of a patent issuing for the particular device. The patent application should not usually be made until this matter is determined. In some cases, however, as the cheapest and best method of determining the facts, the application will be made first and the patent office be left to work out any conflicts or interferences.

It must be borne in mind that after the patent office is reached, conflicts may be found in applications already in the office, which have not yet been granted and are therefore not open to inspection, and that such obstacles can be brought to light only by the filing of an application. As soon as this has been filed the patent office will notify the applicant of any

conflicts in pending patents and he will then have an opportunity to prove, if he can, the priority of his own invention, or of those parts which are in interference.

The character of the patent application will depend almost entirely upon the nature of the invention. A fundamental patent covering broadly the application of a general principle, is, of course, much to be desired. Such a patent, for example, was the one granted Bell for the telephone which covered the transmission of articulate sound by means of electrical impulses. This was indeed basic, applying to every practical method of transmitting articulate sound by electricity and securing the field to Bell and his licensees as an absolute monopoly for the life of his patent. This patent was fiercely attacked but was upheld—whether justly or not is beyond the scope of this volume—and as long as that one principle was effectually upheld, the telephone field was theirs. Others invented very excellent telephones and various improvements in telephones, but all were subservient to that jealously guarded principle and could not be used during the life of this basic patent without the somewhat costly consent of its holders.

Where it is not possible to secure such a basic patent, or where the principle so secured is merely a feature and not sufficient to properly cover and protect the whole invention, the present day practice is to make multitudinous claims on the principles and combinations employed and to make many applications for patents on the different portions of the machines. Thus in the case of an automatic perforating machine,

whereby a paper tape is perforated with telegraphic signals and is later used to send these signals over the line, the machine being operated by a keyboard much like that of the typewriter, the machine itself is covered by a general patent with some forty or more claims. Another patent with almost as many claims covers the keyboard. The direct perforating apparatus is covered by another multi-claim patent and so on. As high as seventy or eighty patents will sometimes be taken out on an important invention, or on one that is to be protected to the fullest possible extent.

Such a procedure is undoubtedly good business practice where the invention is of material value. From the legal standpoint, a patent of multitudinous claims would not usually cover or be worth more than the ordinary modest patent of from two to a dozen claims, nor would numerous patents protect better than a few. If, however, another inventor should contemplate entering that particular field, it would be very discouraging to find it already thickly covered with patents and claims, and, as the ordinary inventor cannot possibly distinguish that which is really good as a protection from that which is only good as a bluff, the practice has a real "scare crow" value quite outside and apart from any legal utility.

The Government fees on patent applications are \$15 at the time of filing and \$20 when the patent is taken out. After notice of allowance of a patent, the inventor has six months within which this fee may be paid and the patent be issued. The general purpose of this six months of grace is to give the inventor time to

make his applications, if any, for foreign patents. As the patent dates from the day of issue—not from the day of allowance—it is customary in the case of valuable inventions to let this six months' period almost expire before the patent is taken out in order to secure the latest possible date on the patent. If the invention is of considerable value, foreign patents will, of course, be applied for meanwhile. The life of a mechanical or process patent is seventeen years.

It is almost inevitably the case that a device as first patented is in a condition susceptible of much improvement. If the invention be of sufficient value to justify it, expert mechanics are frequently employed to watch its operation and devise improvements upon it, which are promptly covered by patent. Whether experts are employed for the purpose or not, improvements are almost sure to suggest themselves to those in charge of the mechanism and any such improvements if of value should be secured by patent. In this way valuable inventions are frequently controlled long after the expiration of the original patents, through almost equally valuable improvements.

It should always be borne in mind that patents while very excellent in themselves are not by any means a complete protection against competition or the construction of similar, or, sometimes, even of the same device. Defects or weaknesses may be found in the patent, other methods of accomplishing the same result may almost always be found, or the patent itself may be attacked and bodily overthrown. For this reason, as has been said, as well as on grounds

of general prudence, the patent should be strengthened in every possible way,—by blanket claims, numerous original patents and by subsequent patents on improvements.

Patents are also occasionally subject to attacks which can be only described as piratical. A concern financially strong sees a weak concern enjoying a valuable patent. It then begins a deliberate infringement. Suit is naturally brought by the owners of the patent, but the advantages here are all with the strong. The weaker party cannot usually match the legal "heavy weights" opposed to it, nor can it even stop the infringement during the progress of the suit, save by giving heavy bond. If this is not possible, the stronger party continues its infringement meanwhile and actually weakens and injures its opponent by means of its wrongful competition and its purloined profits. The suit itself is long and costly, and too often right and justice are defeated by the inability of the weaker party to pay the price. In such case the suit fails from lack of prosecution, or from ineffective prosecution. In either case the weaker party has been deprived of its property by as high-handed and iniquitous a proceeding as ever disgraced the robber barons of medieval Europe.

Of happier resultant was the suit of the Goodwin Film and Camera Company against the Eastman Kodak Company, settled hardly more than a year ago in favor of the Goodwin Company. Goodwin was a clergyman with a taste for chemistry. He knew that an elastic photographic film was greatly desired. He

knew also that his own salary was sadly inadequate, and to meet this condition he undertook to solve the problem of the flexible film.

Goodwin's efforts were finally successful and on May 2, 1887, he filed his application for a process patent for the flexible film. Then his troubles began. For eleven years his application was in the Patent Office and was rejected by five successive examiners. As stated in the final opinion confirming Goodwin's right to the process, "The long delay and the contradictory rulings of the Patent Office would have discouraged an inventor who had not supreme faith in the justice of his cause." Meanwhile the chemist of the Eastman Company "discovered" a similar process, applied for a patent in the early part of 1889, and received his patent before the end of the year. The Eastman Company thereupon began the manufacture of the film and when, in 1898, Goodwin received his patent, the Company's sales were already large and enormously lucrative.

Goodwin was able at this time to interest friends with money in his process. At first they tried to adjust matters with the Eastman Company, but, failing in this, brought suit. The litigation was long and costly. Begun in 1902, it was not finally settled until the latter part of 1913—more than twenty-five years after the date of the patent application. The result was a complete vindication for Goodwin, who, however, had died in 1900—thirteen years before this result was reached. The payments made by the Eastman Company in settlement of the matter are said to have run well up into the millions of dollars.

CHAPTER XIII.

TRADE-MARKS, TRADE-NAMES AND COPYRIGHTS.

A trade-mark may be roughly defined as a distinctive name, expression, device or motto, used to designate a particular product, or class of products, or line of goods, put out and dealt in under that distinctive mark or designation. Under the proper conditions, the parties originating and using such distinguishing name or mark, acquire a right to it as against any other attempting to employ it for the same purpose. This right is a clearly defined common law right and the ownership of trade-marks may be transferred as may the ownership of any other kind of personal property.

The general subject of trade-marks can be treated but briefly here. In most states, laws are provided for their registration and there is also a national law permitting the registration of trade-marks in the patent office at Washington. This registration, whether State or National, does not in itself vest the right to a trade-mark in the individual, but is merely a public notice that the particular trade-mark is being used and is claimed by the person registering it. Any right to its exclusive use would exist no matter whether the mark were registered or not. The great advantage

of registration is found in case of litigation. If other parties use the mark the registered owners—if the matter is brought into the courts—file the evidence of registration. This is considered *prima facie* proof of ownership and the offending parties must then either show that they have a superior right to the ownership of the mark in question, or lose their cause. If, however, the mark had not been registered, the burden of proof is reversed. Then the complainant parties, instead of merely submitting evidence of registration, must bring proof that they have been using the trade-mark in question and that their use and right antedates and is superior to that of the defendant parties. In other words, the registration of the trade-mark does not establish the ownership of the mark, but is *prima facie* proof of such ownership, and any party infringing or contesting this ownership must prove a superior right or relinquish his claims.

The registration of a trade-mark is not therefore of importance as a means of acquiring ownership, but only as a public notice that ownership therein is claimed, as a coign of vantage from which to conduct the fight in case of litigation, and as a measure by which the burden of proof is shifted to the opposing parties.

Ownership in a trade-mark has the advantage of not expiring by time limitation as does the patent. It is not a special concession or reward from the Government to genius or enterprise. It is merely a private right in and to a property created by the energy and ability of the originator, and, like any other property

right, inuring to the benefit of the owner or his assigns in perpetuity or until lost by disuse or abandonment. The Government certificate of trade-mark registration does, it is true, expire and must be renewed from time to time, but the ownership of the trade-mark does not expire as long as it is in active use.

An established trade-mark is not infrequently the most valuable asset of a flourishing business, practically representing its good-will. In many cases, where fully established, its protective value is actually greater and far more desirable than that of the ordinary patent. The respective merits of the different methods of protection are well illustrated in the cases of the two well-known and exceedingly profitable pharmaceutical preparations, phenacetine and vaseline.

Phenacetine was held by a process patent. The life of this patent expired some years since, throwing the manufacture and sale of phenacetine—as phenacetine—open to the world and ending the long and exceedingly profitable monopoly enjoyed by the patentees.

Vaseline, on the contrary, is not protected in any way by patent, but the name of the substance, “vaseline,” is owned as a registered trade-mark. Under that name the product was originally brought out and introduced to its multitude of users, and by the name alone it is now held. That is, the process by which vaseline is produced is known to the trade generally and the substance may be made and sold by anyone under any name except vaseline. As a matter of fact it is largely manufactured and sold under other names, as notably that of “petroleum jelly.” The name vas-

eline, is, however, the exclusive property of the company by which it is registered, and so well is this name established that while the company does not control the entire trade in the product, it does control the most profitable portion of it and will continue to do so as long as the product is properly made and properly kept before the public under the name vaseline.

The holding power of an established trade-mark is surprising. Such a name stands for the formula of the preparation covered and all its qualities. Once fixed in the public mind and properly followed up, its displacement is almost impossible. The only way in which it can be overthrown is by the substitution of some other trade-marked article of the same nature, and in this way only with extreme difficulty and with assisting laxness on the part of the owners of the established mark. We all recognize this in our personal experience. Some certain remedy suits us; we like a certain kind of shaving soap; we are accustomed to using a particular brand of tooth-powder, and we continue to buy and use these particular articles indefinitely and without asking or caring about anything else for the purpose. Other articles may be equally good—frequently better—but we are not concerned, much preferring to continue the use of those we already have.

In the kitchen Dr. Blank's baking powder has been introduced. The cook learns how to use it with excellent results, or results that she esteems excellent. Thereafter no other baking powder appeals to her, no matter what its claims. Ordinarily she will not even try it. If she should be persuaded to do so, not understand-

ing the new powder nor how it is best used, her results will hardly be satisfactory. She prefers old friends to new anyway and joyfully returns to the familiar brand. Further she is a zealous champion of the old baking powder and, in and out of season, is always ready to recommend it and fight in its defense. As an advertising agent she is invaluable and quite inexpensive.

All this is merely a manifestation of the natural conservatism of human nature,—a following of the lines of least resistance. Once started in any particular direction, or in the use of any particular article, an individual may be depended upon to continue in that direction or the use of that particular article until some active influence is exercised to change his course. Furthermore if he is a free agent and has not yet adopted an article that he must sooner or later use, he will in nine cases out of ten take up the article used or recommended by those around him, when the time for adoption comes. This being recognized as true, the enduring value of an established trade-mark may be realized.

Mr. Rowell in "Forty Years an Advertising Agent" discourses interestingly on this subject. Speaking of Pond's Extract, he says that Dr. Humphreys of Homeopathic Specifics fame, who had theretofore owned the trade-name mentioned, was glad to part with a business associate "even at the expense of allowing him to take away the most valuable trade-mark the concern had possessed, no less a trade-mark than 'Pond's Extract,' a preparation of Witch Hazel that is a household remedy from one end of America to

the other. What a commentary it is on the value of a trade-mark. The Humphreys people had made Pond's Extract for years. It was admittedly a preparation of Witch Hazel. They could no longer sell it as Pond's Extract, that privilege had passed to Mr. Hurtt, but dozens of other people were selling extracts of Witch Hazel and the Humphreys people had still just as good a right to make and sell an extract as anybody else. They could call it Humphreys' Extract but not Pond's. Everybody had heretofore bought Pond's Extract of the Humphreys concern; now they could buy Humphreys' Extract there, but not Pond's. To get Pond's they must go elsewhere. And yet the Humphreys' Extract was identical in composition with Pond's, was made by the same people that had always made Pond's and was sold in larger bottles and at a lower price; and for all that the people would have none of it. They had learned to use Pond's and would have no other. I had knowledge in the earlier days of a similar case. Two men were part owners of a preparation for the hair called Hall's Hair Renewer. They were not agreed on business methods and one disposed of his interest in the concern to the other and that other became a millionaire doing business at Nashua, N. H. The first man knew just as well how to make the preparation, and did make it, and put it on the market, and he advertised it, too, only it was Plummer's Hair Renewer and not Hall's. Everybody wanted Hall's, nobody would have Plummer's, and the money spent in advertising it was wasted. After a time the owner of Hall's Hair Re-

newer, having become wealthy, had social aspirations that the patent medicine business did not aid, and the renewer was sold for a great price to J. C. Ayer & Co., of Lowell, who had already exploited with some success practically the same thing under the name of Ayer's Hair Vigor, but could not make it compete with Hall's that had been earlier in the field."

How a trade-mark is to be selected and established is too extended a discussion to be undertaken here. The name or mark should usually be distinctive and striking as easier to fix in the public mind. Given a good trade-mark and a fairly good article to support it, the rest is merely skilful, extensive and long continued advertising and in connection therewith the proper maintenance and supply of the article covered. There should be no variation of quality or failure of supply. Nothing discourages the consumer more than the inability to get the article he wants at the time he wants it, or discourages him quicker than to get his favorite article and then to find it vary from the familiar standard,—presenting a different appearance, taste, odor or effect. Man wants variety but not of that kind.

The protection of the trade-name is much akin to the protection of the trade-mark, though the trade-name is not registered or officially recognized in any way by the National Government. It is merely the name of an individual, firm or corporation under which a business is carried on. The right of the owners to this name is a fully recognized common law right and may be protected, where necessary, by direct legal

proceedings. Ordinarily there is no greater difficulty in this than in the protection of any other property right.

Difficult cases sometimes arise, however, where a person whose name is similar to the name, or leading name of some existing firm or company, adopts practically the same title for a similar business. Speaking generally, a person cannot be prevented from using his own name in the conduct of his business by the fact that some other party, to whom the name also belongs, is already conducting a similar business under that name. While this is true, the courts can usually be depended upon to enjoin any use of a name plainly intended to utilize or to injure the reputation of a name and a business already in existence.

In a well-known New York case (*Meneely v. Meneely*, 62 N. Y. 427), the doctrine is laid down broadly: "Every man has the absolute right to use his own name in his own business even though he may thereby interfere with and injure the business of another person bearing the same name, provided he does not resort to any artifice or contrivance for the purpose of producing the impression that the establishments are identical, or do anything calculated to mislead. * * * A person cannot make a trade-mark of his own name, and thus obtain a monopoly of it which will debar all other persons of the same name from using their own names in their own business."

Under some circumstances the trade-name practically takes the place of the trade-mark. This is true

of the old, well-established firms, companies or enterprises, the reputation of whose names has been built up by the excellence of their goods, or perhaps through the fact of their being first in the particular field in which their business lies.

A good example of this, and one which also well exemplifies the all-around protection that should be given an enterprise, is furnished by the Remington typewriter. This typewriter was the first practical machine to be constructed and was brought out under the name of one of its inventors,—“Remington.” The original machine was naturally very fully protected by patents. Many improvements were made later and all were duly and fully covered by patents. A trade-mark was adopted in the early history of the machine which, in the form of a red seal, is to be found on every Remington typewriter and on everything connected with the machine. The name “Remington” was, however, made the principal feature and given every prominence. Even the name of the firm which controlled the sale of the machine for the larger part of its history was not allowed to interfere with the all-important trade-name “Remington.”

This machine being the pioneer in its field found no existing demand for typewriters. It at once proceeded to create and supply a demand, which, as there were no competing machines, was exclusively a demand for Remington typewriters. The machine was constantly and vigorously pushed, and so favorable were the first conditions and so well were the opportunities improved that when, by the expiration of the

principal patents and the invention of other operating principles, the typewriter field was partially opened, the Remington was too firmly entrenched to be displaced. There were other machines and good machines then on the market and they secured a portion of the trade, but the Remington held and still holds its place as one of the best-known and most widely used American typewriters. It may be stated broadly that there are no patents of any material importance now protecting the Remington machine, its position being held solely by means of the trade protection afforded by its name and trade-mark, sustained by good business management and by the continuing excellence of the machine.

It may be noted, however, that where a trade-name or a trade-mark has become so closely identified with a patented device or process as to stand in the public mind for that device or the product of that process, the protection of such name or mark is lost on the expiration of the patent. Thus the exclusive right to the name "Singer Sewing Machine" was lost to the original owners as soon as the patents on the Singer machine expired, the courts holding that, as the term had come to designate a particular kind of machine, it had become public property. Or had the vaseline process been patented, the owners could not have held the trade-mark "vaseline" after the expiration of their patents, as both the product and the name would have then become the property of the public.

In some lines, enterprises may be more or less protected by copyright. This protection, where possible,

is of the utmost importance, but its application is too limited and too well understood by those interested to require extended consideration here. It differs from both patents and trade-mark registration in its nature, being the absolute certification by the Government that the author or owner, as the case may be, is entitled to certain productions, of a literary or artistic nature, which cannot thereafter be used by others either in whole or in any material part without the consent of the author. The copyright is not subject to attack—unless by direct charge of wholesale plagiarism, or theft—nor, on the other hand, does it protect anything except the special book, picture, musical composition, or other production for which it is granted. Another author or artist may, if he so desires, produce another book, or picture, entirely similar as to subject matter, provided only that the wording or the treatment is different. Ideas are not protected by the copyright—only the expression of those ideas.

No attorney is needed to secure a copyright. The process is simple. Blanks are furnished on application by the Copyright Department of the Library of Congress with full instructions as to the formalities to be observed and as to the preparation and filing of the application. The fees are nominal,—\$1 for each copyright and ten cents for revenue stamp on the application. The copyright so secured extends over a period of twenty-eight years and may at its expiration be renewed for a period of fourteen years.

Under the general rules of “unfair competition,” a protection akin to that afforded by the trade-mark

and the trade-name is extended to any distinguishing feature employed in marketing a particular product, or the goods of some particular manufacture. Thus, if a characteristic label has been long in use, or a particular size, shape or color of package has been employed to distinguish certain goods, the courts will not allow a competitor to adopt the same style of label or package for similar goods in order to avail himself of the reputation already attained by the original product.

CHAPTER XIV.

SECRET PROCESSES.

In the case of a patentable process, it is often a perplexing matter to decide whether it is better to patent it or to hold it as a secret process. If it is patented, the process must necessarily be revealed in the application for patent and is readily accessible to any interested party. If not patented, anyone who discovers or stumbles upon the process has the same right to its use as has the inventor.

If the process is one easily discoverable by those investigating along its general lines, or one that is perhaps suggested by the nature or appearance of the product, it would naturally be patented as the only feasible means for its protection. If, however, the process is intricate, or outside the usual lines of investigation, or of such a nature that patent protection is difficult of enforcement, it is usually the better policy to operate it as a secret process and to risk the chance of its discovery, or of its being revealed by some one in the secret.

The conditions surrounding a process make its protection difficult. In this it differs from a mechanical device, inasmuch as any infringement of this latter shows on its face, and a mere inspection of the device is sufficient to disclose the fact, while in the case of a patented process there is usually nothing in the fin-

ished product to show whether it was made by the patented process or by some other process. Then if a competitor manufactures a similar product, it is impossible to tell from any internal evidence that it was prepared by the patented process, and the only way by which an infringement may be discovered is by an investigation of the process actually employed. This, as the producer is under no necessity of either giving information himself or of admitting the investigator to his factory, is ordinarily a matter of very great difficulty. Frequently it is impossible.

A recent instance may illustrate the difficulties of reaching a decision in matters of this kind. One of the smaller chocolate manufacturers, after long experimenting, discovered a very valuable chocolate preparation produced by a peculiar treatment and blending of his materials. The preparation was different from anything else of the kind on the market, was one much desired by chocolate manufacturers and for which many of them were then working, and was far superior to anything as yet produced. As soon as the process was perfected the question at once arose as to the best means for its protection.

If patented, its peculiar features and the method of its preparation would be published to the world and would be very likely to give his competitors hints or suggestions that might lead to other methods of preparing the same or a practically similar compound. Or if the process thus revealed should be deliberately stolen and used by these other manufacturers, it would be extremely difficult, if not

impossible, to secure evidence of the theft. That is, if some other manufacturer of chocolate preparations should decide the process to be a good thing, should steal it bodily, devote some secluded room of his factory to its preparation, put the whole matter into the hands of a few trusted employees, and then come out with an announcement of his important and valuable discovery of a new chocolate preparation, the detection of the fraud would be almost impossible. The claims made for the stolen preparation and its appearance and qualities might be identical with those of the legitimate product, and the owner of the process might be morally sure that his process was being used, but how could he produce the facts necessary to substantiate his belief and give him a fighting status in the courts? He must not only show that the preparation was the same as his but must also show that it was produced in the same way—that is, by the process revealed in his patents. His own belief would have no weight as legal evidence. He could not compel the dishonest manufacturer to come into court and make known the process actually used. Practically, then, the only possible methods of securing the absolute proof necessary for the protection of his rights, would be to introduce spies into the competitor's factory, who might discover and testify to the process used, or to win over some one or more of his competitor's workmen engaged in the process and employ their testimony to prove the infringement. Either of these plans would be of great difficulty and of doubtful propriety.

On the other hand, if the process were maintained as a secret one, the owner's exclusive interest in it would depend solely upon his ability to keep the secret to himself. If he were able to manufacture the material himself, without help, his exclusive possession would be easier to maintain, but this is impossible in most commercial processes, and in the particular instance the secret would of necessity be intrusted to his workmen. These workmen, or one of them, might then be drawn to his competitors by higher wages, or the secret be discovered by direct bribery, or by spying, or by other underhand methods. Or if nothing of this kind happened, the finished product might give his competitors some hint as to the direction in which to work and his process be discovered by direct experimental investigation. No matter how, if the process once became known, its value as a monopoly would be hopelessly lost. The inventor's right to a patent would by that time have been lost and he would be utterly without protection.

In the particular case the writer's preference would be strongly for the maintenance of the operation as a secret process. It would, as suggested, be liable to discovery, but the difficulties of enforcing patent rights in a case of this kind are practically insuperable, while the probabilities of maintaining the secrecy of the process for at least a considerable time are excellent. With a limited number of trusted workmen, given perhaps some interest in the product, and with all possible safeguards thrown round the process, its secrecy might be maintained indefinitely—perhaps for a far

longer period than the life of a patent—whereas the process if patented would certainly become public property at the end of the patent period and could not be efficiently protected at any time. In effect it would become the property of any unscrupulous manufacturer from the day the patent was issued.

Also by maintaining the process as a secret one, it could, under any ordinary circumstances, certainly be preserved to the owner for a sufficient length of time to enable him to throw around it the additional protection of his trade-name and a trade-mark, as already discussed. In this event the actual process of preparation would become a matter of much less vital importance, and, in fact, might finally sink to the position of a mere incidental feature of protection. As already stated, the processes of manufacture of numerous and very valuable trade-marked preparations are well and generally known but their value to their owners is not materially affected by these conditions.

In conclusion it may be said that in any case in which the process to be guarded is one that can be kept in the hands of one man, or of a few men, and is of such a nature that it is not likely to be discovered, or will not be revealed by the product itself, it is best held as a secret process.

A secret method of tempering watch springs might serve as an illustration of this kind of process. Here one man, if the process were simple, might himself temper enough springs to supply the world, and the process should undoubtedly be kept a secret. To patent it would in effect make it public property, as the

prevention of infringement would from the nature of the case be impossible.

When, however, a process requires the employment of many men, who either necessarily know, or are in a position to learn its secret, or when it is of a nature that necessitates its public exposure to a greater or less degree, it is better patented. Under such circumstances, its protection for any length of time as a secret process is practically impossible, and on the other hand it could hardly be adopted and used by a rival manufacturer without detection.

Some of the modern methods of producing and treating iron and steel, are examples of this kind of process. Here the operations must be conducted on such a scale and under such conditions that the secret could not be preserved and, on the other hand, their surreptitious employment is practically impossible. In any such case the owner may patent his process with entire assurance that if it should be used without his consent, the discovery of the fact and the proof of such use are matters presenting but little, if any, difficulty.

Between the process which should manifestly be kept secret and the process that is as obviously best protected by patent, come a multitude of processes for which the best method of protection can only be decided by a consideration of the particular conditions. In some few complicated processes the protection of patents may be secured for parts of the process while other parts are kept secret, but usually one or the other method of protection is alone to be had.

CHAPTER XV.

MONOPOLIES.

Freedom from competition, or in other words, an exclusive control or monopoly, is the desideratum of the business world. In all the methods of protection discussed in the preceding chapters, the end sought is relief from competition and the establishment, as far as possible, of exclusive rights, and the more fully this is done and the nearer a monopoly is approximated, the smoother the commercial pathway of the fortunate individual, and, governed by the possibilities of the particular line of business, the greater his rewards. The proper protection of a business then becomes of vital importance and a general discussion of the subject and of the methods by which monopolies are established and maintained will not be out of place.

As will be noted in some of the examples already given, it is at times possible to utilize efficiently several of the usual methods of protection for a single product or enterprise. For instance, the chocolate preparation discussed under secret processes, might be primarily protected by patent, or if not patented, be held as a secret process. Or the process might be partially patented and partially held as a secret process if capable of such division as to permit of this double protection. Next, if not patented, the preparation could be sold

under the protection of a trade-mark, and finally, its sale would naturally be conducted under the trade-name of the concern. The preparation so protected would have but little to fear from outside interference or competition so long as it was handled with reasonable business ability.

Where the enterprise will not permit of the methods of protection discussed, other means must be found or devised that will preserve the enterprise from the effects of destructive competition and enable it to at least maintain its own.

In the standard lines of business there is, as a general rule, but restricted scope for the protective measures already considered. The ground is too open and too well known to permit of anything approaching monopoly, save such as may be secured by a careful observance of the laws of supply and demand, by judgment in the selection of a location, discretion as to the character, quality and quantity of stock, honest and courteous treatment of customers and of employees, and general business intelligence and ability. Various subsidiary or incidental lines or articles may perhaps be protected by patents or trade-marks, or be held as secret processes, and the trade-name itself is occasionally the equivalent of a monopoly, and is at all times, if properly worked up, a protective and retaining feature of great value. Beyond this the field is open, and, barring inequalities as to capital and natural abilities, the fight is a fair one with no favors.

In such cases, not permitting of patent, trade-mark or other special protection, or only partially so, and

not possessing any of the usual features of a monopoly, the same ends, as nearly as may be, are attempted by very diverse methods.

Thus one man will advertise so extensively and so persistently that his competitors of quieter tastes, or less aggressive dispositions, are lost in the turmoil. They are still there but so completely overshadowed that the blatant advertiser has most of the advantages of exclusive control.

Or again some one will gain possession of improved machinery, or better facilities, or secure the same ends by better management or superior ability, and rout competitors by either supplying more or better goods for the same money, or the same goods for less money, or doing something else equally destructive of their business and peace of mind.

Or another commercial genius will discover an industrial line of quite low resistance, something which has been neglected or overlooked, or which has been opened up by changing conditions, in which he has a vantage ground over others. Instead of blazoning forth his discovery to the world and to his competitors in particular, he carries on a still hunt,—the quietest campaign possible, reaching his market or consumers in the most unobtrusive way he can devise and prospering perhaps for years without competition, because those who would otherwise be his competitors have no idea that he has any business worth competing for, or which they could follow with profit to themselves.

The writer has in mind an instance of this kind

which was brought to a very unfortunate conclusion by the unintentional interference of a paternal government. Just before the Civil War a new firm had been formed in a flourishing town of one of the Central States to carry on a general toy and notion business. It was the only establishment of the kind in the place and for a time did a very ordinarily profitable business, paying rent and a living profit but nothing more. With the advent of the war, however, a change came over the scene. A period of inflation began, money was plentiful, it had to be spent and the young firm found itself in a singularly favorable position to facilitate this operation. The partners were alive to the emergency, added to and extended their stock materially, and were shortly doing an astonishingly profitable business. They did not deem it necessary to proclaim this fact, however, but merely advertised their business in the usual way and jogged along as quietly as if they were not running one of the most remunerative little monopolies in the place.

This went on to the satisfaction of all parties—and especially of the partners—until the Government in its wisdom saw fit to impose an income tax upon the population of the loyal states, and as a means thereto required everyone to submit a sworn statement as to his or her income. Unfortunately the members of the young firm were respectively possessed of that, at times, exceedingly embarrassing and uncomfortable business appendage,—a conscience. Accordingly they returned an honest report of their income, which, in connection with many other reports, some correct

but most of them enormously discounted, was forthwith published in the daily papers. It was a revelation to the burghers of the town. They arose as one man, including many women, and before the next Christmas every corner grocery, every dry goods store, and practically every other establishment in town had added an annex for the sale of toys and notions. As a result, what had been before a most prosperous and profitable enterprise was reduced within a season to the verge of disaster, and, as a matter of fact, the nature of its business was shortly changed.

A monopoly may be established either by exclusive control of a product, or by control,—usually by virtue of location,—of the market for a product.

A very good example of the establishment of a monopoly by securing practical control of the entire output, is found in the history of the Kimberly diamond fields. The great bulk of the diamond supply of the world comes from these fields. Formerly the mines of the district were in the hands of a great number of small owners operating independently and as each man saw best, without regard to the laws of supply and demand or any other economic principles. Their only anxiety was to secure and realize upon the largest possible output in the shortest possible time.

This was a very natural proceeding, but it entirely overlooked the great natural possibilities of monopoly in the Kimberly fields. Instead of the peace of mind, great profits and other comfortable features of a monopoly, there was the most active competition, overproduction, and resulting stress and distress, until a

glut in the diamond market ensued, prices fell disastrously, and the whole business was in a state of demoralization. The enormously important fact that practically the world's supply of diamonds was coming from these few acres of blue clay was absolutely ignored.

At this stage of the proceedings, Cecil Rhodes and his associates, who, whatever their shortcomings in other directions, were unquestionably men of great business ability, saw the industrial bearings and possibilities of the conditions. Without hesitation they stepped in, purchasing, absorbing, compelling as best they might, until all the rival ownerships were consolidated. They then systematized the business, abolished all independent and competitive operation, put the mines under one capable management, regulated production and thereby prices, and from a confusion of warring elements evolved a complete and smoothly operating industrial machine.

As soon as this industrial reorganization was completed the Kimberly mines controlled and still control the diamond markets of the world. By increasing the output, or by allowing a larger portion of the output to go on the market, its managers can at any time lower the price of diamonds in every civilized country of the globe. By restricting the output, they can raise the price of the gem wherever it is bought or sold. The market is in their hands, and the whole problem narrows down to the one point of the proper production to secure the best results—the greatest profit for the owners of the mines.

It is manifest that if the output were increased too greatly, the price would decrease in proportion or even in greater ratio, the profits of the owners becoming even less than on a smaller production. Also the volume of business and, as a consequence, the operating expenses would be greater and the source of supply—which is not supposed to be inexhaustible—would be rapidly depleted. If, on the other hand, the output be restricted too far, the price would immediately rise, but the demand would as immediately fall, and the profits of the owners be curtailed by the decreased demand. Also if the price were raised unduly, the activity of the other diamond-producing regions of the world would be promptly and greatly stimulated, or perhaps new fields might be discovered, all resulting in increased competition and a loss of profit to the Kimberly.

Another example of a monopoly from the nature—or conditions—of the product, was, for a number of years, afforded by the great pitch lake of Trinidad. This enterprise is an interesting one, not only because of the original features of monopoly which brought it into prominence, but also because of the aggressive ingenuity with which this natural monopoly was perpetuated and protected long after it would, in the ordinary course of events, have fallen into a condition of innocuous desuetude, or at least into the position of very secondary importance where it properly belongs.

As a matter of fact, the material known as Trinidad asphalt is not peculiarly favorable for paving purposes. It is, as taken from the lake, but from 50% to 60%

asphalt, the balance of the constituent materials being designated by those opposed to the Trinidad asphalt as "trash." These other materials are really the debris that has fallen into the lake or become incorporated into the asphalt while in the lake basin. A very large proportion of this foreign material is organic matter, actively detrimental to the quality and general use of the asphalt. The material as taken from the lake must, therefore, be refined before being used for paving purposes, but it is impossible to entirely remove the organic matter. Also the asphalt as refined does not possess enough natural asphaltic oil to make it a suitable paving material, and, therefore, before use a certain amount of petroleum residuum is added to give it the necessary life and "staying" quality.

As will be seen there were serious difficulties in the way of using the Trinidad asphalt for paving purposes and the original promoters of the enterprise, Mr. Alonzo Barber and his very efficient ally and chemical expert, Prof. de Schmedt, deserve much credit for the persistence and intelligence of their original study of the material and for the very excellent paving material they finally succeeded in producing from it.

As soon as these gentlemen had solved the problem of the reasonably successful use of the Trinidad asphalt for paving purposes, the Barber Asphalt Company was formed, and proceeded with intelligence and deliberation to build up and fortify one of the strongest monopolies of its day.

There were in use at that time other asphalts much

better for paving than the Trinidad, but these others were European asphalts, were somewhat costly for use on this side of the world, and, for various reasons, did not produce a favorable impression when first laid in this country. They were not serious competitors and the Barber Asphalt Company gained the first hold. Also in spite of the fact that the Trinidad asphalt lake was and is crown property, belonging to England and merely held under lease and royalty, the Barber people managed with much astuteness to produce the impression that the Company was—and with some justice, for the asphalt was never successfully used in any foreign country—an American enterprise, and that for this reason its product should be given preference over any other asphalt.

Also the American public was carefully and systematically educated as to the merits of the pavement, and the name of the Barber Asphalt Paving Co., and the material "Trinidad" asphalt were so closely associated with the whole industry that the mere mention of asphalt paving at once suggested both the names of the Company and its asphalt.

It may be mentioned that at this time other and superior asphalts, such as the Bermudez, the California asphalts, the sand and limestone asphalts of the interior states, etc., had been found and were being produced to a limited extent. This, however, only spurred the Barber people to higher flights of imagination and they actually discovered that the defects of their material were excellencies that could neither be found nor reproduced in any other asphalt.

Acting on this discovery they declared that the impurities of Trinidad asphalt were natural additions essential to its excellence and not to be replaced in other asphalts by artificial additions; further that the heavy oil added to the Trinidad was superior to the natural oils of the other asphalts and in short, to sum up the whole matter, that Providence, perceiving somewhat tardily the necessity and importance of asphalt pavements, and noticing that no provision had been made therefor in the original creative process, had prepared the Trinidad Lake asphalt for the express purpose, and that any doubts cast upon the excellence of the material bordered closely on the impious.

This was ingenious but the Trinidad people did not place their trust entirely in Providence. By unremitting and well rewarded missionary work among the local politicians of all places where asphalt paving was being laid, or likely to be laid, they succeeded in convincing these local politicians of the marvellous qualities of Trinidad asphalt and in committing them to the furtherance of the designs of Providence in the matter of its use. So well done was their work that almost every municipality of the country which advertised for asphalt paving either inserted a provision calling for Trinidad asphalt, or for an asphalt of similar composition, which could not, of course, be procured outside of Trinidad Lake. As a result of all this well-directed effort the asphalt held its own in the face of the most strenuous opposition for a long term of years and even now the specifications of many of our cities practically call for Trinidad asphalt.

The whole enterprise is interesting as showing the strength of a monopoly once established and the distance to which it can be carried in the face of conditions distinctly unfavorable.

In the case of the Standard Oil Company we find a monopoly where nature did not intend one, and it is undoubtedly the most remarkable case of the kind in industrial annals. Here the process that obtained in the case of the Trinidad Lake asphalt was reversed, and the enterprise instead of beginning as a natural monopoly and then being maintained as an artificial one, was first inaugurated and maintained as an artificial or forced monopoly, until it had attained such size and strength that it was enabled to change its character to that of a natural monopoly.

Oil is found in every part of the country and in every part of the world. Its distribution is so wide and the quantities found are so excessive that at first sight there would not appear to be any possible opening for a monopoly—not nearly so good as in coal or salt, or copper or iron, or a dozen other of the extensively used and widely distributed necessities of life.

It is not at all probable that Mr. Rockefeller had any idea in his early connection with the oil business of establishing the very complete and all absorbing monopoly that he did, nor of the enormous magnitude of the work he had undertaken. Nor is it at all probable that any such combination or absorption, as he effected could have been brought about by fair and honest means. It did not matter at all to Rockefeller, however. He saw the goal immediately before him.

He also had a conviction that his career had been arranged by Providence—a pleasing conviction that seems to prevail among monopolists—and that nothing could be allowed to stand between him and the success for which he was destined. At any rate he, or his associates, did not allow anything to stand in the way and by a system of the most deliberate and cold-blooded industrial brigandage, admirable for its detailed, intricate and comprehensive character, and for the intelligence and insistence with which it was carried out, but damnable from the standpoint of morality and the fellowship of man, built up one of the greatest, the most profitable, and the most powerful monopolies the world has ever seen.

The first organization was characterized by a strong centralization of power, by the ability of the men connected with it, and by the unscrupulous character of its operations. Its first strong hold on the situation was secured through special freight rates and then by the iniquitous rebate system whereby its rivals were forced unwittingly to contribute to its power and to their own ultimate destruction. Under this system the organization not only reaped the profits of its own business, but without right or reason—except the power to do so—levied toll on the business of every man who ventured to enter the field as an independent. Oil could not be sold without being shipped, and on every barrel of oil shipped by its competitors the Standard Oil Company received a substantial payment.

The details of the rise of Standard Oil are too well known to require recounting. Suffice it to say

that by rebates and discriminating rates, by controlling the refineries, by controlling the means of storing and piping oil, by controlling everything connected with oil, by buying, crushing, absorbing and destroying competition of every kind, the artificial monopoly at first created was transformed into a natural monopoly practically controlling the entire oil output of the country—so much so that the Standard Oil regulated the price of oil subject only to its own discretion, modified to some extent by the great natural laws of supply and demand—laws which even the Standard Oil Company was not able to entirely overthrow, though it juggled with them greatly to its profit.

Such a monopoly as the Standard Oil Company enjoys might be called a forced monopoly. There are, however, numberless instances of natural and entirely legitimate monopolies, as where a coal mine is opened in such a location as to secure better rates to its particular market than any competing mines, or where a clay bank is discovered that will make a brick superior to anything else in that vicinity, or where a particular soil is found that will grow a certain kind of vegetable or fruit in greater perfection than elsewhere, or where other superiority is given by natural and honestly existing conditions.

Other perfectly legitimate monopolies of a local character are more or less artificial, or are built up, as where a brickmaker discovers that a few brick plants in his neighborhood occupy all the available clay beds and by a combination of these secures a practical monopoly of the brick business in that neighborhood;

or where a coal operator, securing the exclusive right for his territory of a new and very economical apparatus for channeling coal, drives his competitors out of business by cheaper production.

In most cases, however, the advantages enjoyed by any particular enterprise are not sufficient to constitute a monopoly, but only sufficient to render the undertaking more profitable to its owners than are other similar but less favored competitors, as, for instance, where a coal mine is located more favorably, whereby its cost of mining is a cent or two less per ton than its competitors, giving it a better profit than these others but not such an advantage as to enable it to drive them out of business; or where a pottery is located so that it can secure a trifling advantage in freight rates over its competitors, enhancing its profits as compared with those others but not sufficient to constitute a monopoly or permit its upbuilding.

In conclusion it may be said that in every case of successful business, advantages of some kind must of necessity exist to give it such equality with or superiority over its competitors as will enable it to exist, and that in every business its success will be accurately measured by the ability with which every possibility of advantage is discovered and developed. All cannot have monopolies but the best business success requires as near approximation thereto as conditions will permit.

PART IV. CAPITALIZATION OF AN ENTERPRISE.

CHAPTER XVI.

CAPITALIZATION.

Legal Status. Functions.

In Dr. Meade's "Trust Finance" the capitalization of a corporation is defined as "the face or par value of the stock and bonds which the corporation has issued," and this is usually the meaning of the term when employed in the discussions of "higher finance." For the purposes of the present volume the term is employed in its more popular sense, *i. e.*, the capital stock of the corporation or the amount of stock which it is authorized to issue. This includes common and preferred stock, whether issued or unissued, but does not include bonds or any other corporate obligations.

Capitalization is a necessary feature of incorporation. In every state of the Union the laws providing for incorporation, either directly or by implication, require the corporation to have a specified capital stock. The amount of this capitalization or capital stock is in most states of the Union fixed by the char-

ter of the corporation. Primarily, however, it is determined by the parties who have the incorporation in charge, before application is made for a charter. It therefore represents the amount of capital which the incorporators deem necessary for the successful operations of the enterprise under the corporate form or the amount of stock upon which—in their judgment—it can pay dividends. That is, if they capitalize at \$25,000, presumably they either consider this amount of stock requisite for the purposes of the undertaking, or believe that dividends can be paid upon that amount.

In fixing the capitalization of an enterprise the incorporators have wide discretion. They will, however, naturally be governed by the conditions surrounding the enterprise and usually some limitations are imposed by the law.

Laws expressly affecting the amount of capitalization are few. Practically the only ones of importance are those fixing a minimum capitalization, as in New Jersey, where the capital stock must be at least \$2,000, or in New York, where it must be at least \$500. Such laws exist in most states of the Union. A maximum limit is found also in a few states, but the number of these states is so small and the limit is so liberal as to make the whole matter immaterial.

Indirect provisions are, however, more numerous. In many states a certain proportion of the capital stock must be paid in—that is, it must have been issued for value received by or for the corporation—

prior to incorporation, or before the corporation commences business, or within a certain time thereafter. Thus in Maryland one-fourth the capital stock must be paid in within one year of incorporation, and in New York one-half must be paid in within the same time. The severity of these requirements is somewhat mitigated by the fact that payment may be made in property or services, but they naturally tend to place some limitation upon capitalization. In the District of Columbia the provisions are much more severe. Here not only must the entire capital stock be subscribed for in good faith, but ten per cent. of these subscriptions must be paid in cash in good faith before the charter may even be filed. These laws are recent and it is obvious that under their exceptionally rigorous requirements the amount of capitalization of any particular corporation will of necessity be limited to a very conservative figure; also that the airily unsubstantial corporations rather characteristic of the District of Columbia under its former lax laws are now absolutely impossible.

Again, in most states before a corporation may be organized, a fee or tax usually proportioned to the amount of capitalization must be paid the state officials, and thereafter annual franchise taxes are levied. For instance, in New Jersey an incorporating fee must be paid of twenty cents for each thousand dollars of capitalization—minimum fee \$25—and thereafter an annual franchise tax is levied, amounting on capitalizations of less than \$3,000,000 to \$1 for each \$1,000 of stock outstanding. Taxes of this kind mount up

rapidly and in practice have a very material effect in limiting the amount of capitalization.

Also in most states laws exist requiring full payment of all issued stock. That is, every dollar of outstanding stock is supposed to represent a dollar of value actually received by the corporation. In some few states these laws are strictly enforced and are then an effective limitation on excessive capitalizations.

While these laws exist and must be borne in mind when capitalization is under consideration, they are in most states reasonable and even liberal. Even the direct laws mentioned, expressly prescribing the minimum and maximum capitalizations, impose no practical limitation, while the laws requiring full payment of capital stock are in most states so indefinite as to wording or so slackly enforced as to be of but little effect. Further, excessive incorporation fees and franchise taxes and any other requirements as to capitalization, found too rigorous in one state, are always to be avoided by incorporation in some more liberal state. In practice, then, it may be said broadly that the laws affecting capitalization impose material restrictions upon its amount in but few cases, and that while these laws must be considered, they will not as a rule be found either an insuperable bar or even a serious obstacle to any capitalization that may be reasonably desired.

Capitalization has two entirely distinct and very important functions—(1) as a convenient means of apportioning the interests in an incorporated enter-

prise; (2) as a measure of the value of an enterprise. These functions are independent of each other, though both may be, and frequently are, exercised at the same time. Speaking generally, it may be said that capitalization always serves as a means of apportioning interests, and, usually, though not by any means invariably, serves also as a measure of value.

Thus, a partnership business owned by three partners and valued at \$100,000 is to be incorporated. One partner owns a half interest in the business and the other two each own a one-fourth interest. Unless special conditions exist, the capitalization of the corporation would naturally be fixed by the value of the enterprise at \$100,000. The capitalization is then a measure of value of the enterprise. This capital stock is divided into shares of equal value and in the ordinary course of procedure in such an incorporation each partner is given such number of shares as will represent his interest. If the shares are of the usual par value of \$100 each, there will be 1,000 shares in all, of which the first partner will receive 500 and the second and third partners 250 each. That is, their interests, instead of being represented by fractions as before, are now represented by shares of even value, and the capitalization not only represents the value of the enterprise, but serves as a convenient means of apportioning or representing the interests of the owners.

In this case \$100,000 as the value of the business would be a natural capitalization. It is, however, entirely possible that for reasons of policy and expe-

diency, a less amount, as \$50,000, might be decided upon. The laws never interpose any obstacle to capitalization below the real value of an undertaking, and such a proceeding would be entirely within the discretion of the partners. The smaller capitalization would, however, be no longer a measure of the value of the enterprise, though it is still and to the same extent as before, a convenient means of apportioning the respective interests of the partners. In other words, the function of capitalization as a measure of value has been subordinated to presumably more important considerations and is lost, but the other function—as an apportionment of interests—still exists in full measure.

That this is true is shown by a very brief consideration. Under the capitalization of \$50,000, shares being \$100 each, the first partner would have 250 shares, the second and third partners 125 shares each. The number of their shares is changed, it is true, but the capitalization being correspondingly changed, their proportionate holdings and their interests in the business and in its profits are the same. The first partner still has a half interest and the other two still have one-fourth interests as before. If profits of \$10,000 are made and declared as dividends, under the first capitalization they will receive a ten per cent. dividend, amounting for the first partner to \$5,000 and for each of the others to \$2,500. Under the second capitalization the dividend will be twenty per cent., but the amounts received by the partners will again be \$5,000 for the first and \$2,500 each for the other

two. The basis of calculation is different, but the results are the same.

It is obvious that this apportionment of interest by means of capitalization is a very important function. As a rule, many parties are invited to participate in corporate undertakings, each putting in or investing a small sum. Possibly also, if the corporation be a new one, commissions and other obligations are to be paid by stock interests in the enterprise itself. It is clear that if all this were done on the fractional basis that prevails in partnerships, as one-fifth to this man, one-eighth to another, four-fifteenths to another, one-twenty-fifth to another, etc., very complicated and troublesome problems both of practice and bookkeeping would arise. Under the share capitalization used in the corporate form all these differences of interest are represented with accuracy and convenience.

At times a capitalization will be fixed solely for the purpose of apportioning interests without regard to values, and then later as conditions change will itself be changed to serve as a measure of value as well. This is shown very clearly by a case that frequently arises. An inventor devises some mechanism. It is neither demonstrated nor patented, probably existing only as a rude draft or model. The device must be worked out and for this purpose the inventor must secure financial assistance.

Usually in such case the inventor will go to a few of his friends. Perhaps in order to secure the money he needs to complete the invention—say \$1,000—he will offer them a one-half interest, reserving the other

half for himself. Two or three of these friends may form a little pool, one for instance putting in \$500, another \$400 and another \$100. Then their respective interests in the enterprise might be apportioned by means of fractional parts—one-half to the inventor, one-fourth to the first friend, one-fifth to the second friend and one-twentieth to the third. Usually, however, the corporate form would be preferred on account of its convenience and in order to avoid the partnership obligations that might exist under the first plan. Then the question of capitalization arises.

It is obvious that at this point the capitalization cannot be based on the value of the enterprise for the simple reason that this value cannot be ascertained. The invention may prove impracticable; it may not be patentable; it may have been already patented by some one else; it may never be brought to perfection. In any of these events, the invention will be worthless. On the other hand, it may turn out a striking success and be worth hundreds, thousands or even millions of dollars, according to its nature. It is apparent, then, that the capitalization of the enterprise cannot be based on value, and its only function is to measure the interests of the parties concerned.

In this case the amount of capitalization is practically a matter of indifference and is fixed at any convenient figure that will lend itself readily to the requirements of the case. Usually to avoid incorporating fees and expenses, taxation, etc., a small capitalization is preferable, and the company will perhaps be incorporated for say \$2,000, divided into twenty shares

of the par value of \$100 each. Of these the inventor will take ten shares, the first friend five shares, the second four shares and the third one share.

Such a little company would, of course, be looked upon merely as a temporary "bridging" arrangement to carry the enterprise over to a point where the value of the invention might be determined. The only parties concerned are the inventor and his associates and the arrangement meets the needs of the situation very fully.

When, however, the invention is completed and its value can be determined to some degree, and when perhaps large amounts of money are needed for its exploitation, the conditions are very different. Money in material amounts could hardly be raised on the existing capitalization of \$2,000. This must be increased to an amount more nearly approaching the value of the enterprise. The corporation will, therefore, if the invention is one of value, be reorganized and capitalized on a much more liberal basis, the amount of this capitalization then becoming a matter of great importance. Up to this point the real value of the enterprise has not been considered in its capitalization. Now the idea of value comes in and the capitalization is not only to serve as a measure of interest, but as a measure of value as well.

It is apparent from the examples considered that these two functions of capitalization are entirely separate and distinct. Capitalization may or may not be used as a measure of value, but its use as a measure of interest is practically invariable.

It is to be noted that theoretically and even practi-

cally the entire value idea in capitalization may be disregarded. Under the existing laws, capitalization must be expressed in terms of money, but, as already shown, these money terms frequently do not indicate in any way the value of an enterprise. Therefore, while the capitalization is expressed in terms of money, it may still be considered solely from the standpoint of apportioning interests.

For instance, in the inventor's little corporation already cited, the first capital stock of \$2,000 does not in any way express the value of the enterprise. Then, instead of calling the capitalization \$2,000, consisting of twenty shares of the par value of \$100 each, the "value" idea might be dropped entirely and the capitalization be referred to merely as one consisting of twenty shares. Then neither the money value of the total capitalization nor of its shares would be mentioned or enter into consideration unless in case of sale. The inventor, holding ten shares out of the total number of twenty shares, would have one-half the enterprise, and these ten shares represent his half interest equally well whether the value of the enterprise be \$2,000 or \$200,000. In this case the capitalization is regarded purely from the standpoint of shares and not of value. The whole idea is in fact merely a convenient modification of the fractional interest of the partnership.

It may be noted that in New York corporations may be formed on the basis of a specified number of equal shares, but of no definite value, the dollar idea being entirely omitted.

The general proposition is "to permit the formation of a distinct class of business stock corporations whose

capital stock may be issued as representing proportional parts of the whole capital without any nominal or money value." In other words, if any particular capitalization consisted of 100 shares, no nominal money value would be placed upon these shares, each one merely representing 1-100 of the enterprise. As long as stock is not sold, the real value of these shares would be immaterial. In case of sale their value would have to be ascertained either from market quotations or by an investigation of the property owned by the corporation. The matter not being complicated by the usual fictitious money value attached to each share, is not difficult.

This very radical departure from the usual plan of incorporation has not met with popular approval. The idea of value as connected with capitalization is too firmly fixed to be easily disturbed.

CHAPTER XVII.

THE BASIS OF CAPITALIZATION.

The laws governing the organization of corporations undoubtedly contemplate an initial equality between the issued capital stock and the corporate assets,—in other words, as the issued capital stock is the real or working capitalization of the company, that the enterprise shall be capitalized on the basis of value. In some few states direct laws exist to enforce this equality between assets and capitalization. In most states the laws with more or less vagueness prescribe that stock shall only be issued for actual value, or otherwise the party to whom it is issued shall be liable to the corporation and its creditors for the difference between the amount he has actually paid and the par value of the stock. The intent of these laws is clear. Every dollar of issued stock must represent a dollar of value received by the corporation, or to be received should the corporate necessities require.

In practice, however, the laws regulating capitalization are too often evaded, or compliance is nominal, and in consequence frequent and wide discrepancies between the issued capital stock and the corporate assets are found from the very day of incorporation. The value of these assets is professedly taken as the basis of capitalization, but this value is apparently determined by

the exercise of the hopes or imaginations of the incorporators rather than by a careful appraisal.

The requirements of the law as to capitalization merely shadow forth an existing popular demand that it shall be based on values. The law insists—somewhat weakly, it must be confessed—that there must be some connection between the value of an enterprise and its issued stock. The public, in spite of many and grievous disappointments, goes further and insists not only that there must be, but that there is some such connection.

The fact that the nominal value of stock is expressed in terms that directly convey an idea of definite value is probably responsible for the popular position on this subject. If the idea of value were dropped, as discussed in a preceding chapter, and shares in an enterprise were merely offered as proportionate parts of the whole, the question could not arise. Even at the time of incorporation it could hardly be insisted that some definite amount of property must be received by the corporation for every share issued, if no value were assigned to either the share or to the enterprise. The only claim then made for the share would be that it represented a definite part of the whole, and no representation as to its value being made, no set value could be required. Under these conditions, if stock were offered for sale, the principle of "caveat emptor" would control as in any other ordinary business transaction.

Then, if an enterprise were represented by 500 equal shares and a man were offered one of these shares, or in other words, 1-500 of the enterprise, for some certain sum, say \$100, he would, if interested, at once begin

an investigation to determine whether this share were worth \$100, just as before purchasing he would look up the value of a horse or cow or any other article offered for sale.

When, however, the same man is offered a share of stock stated in the certificate to be "of the par value of \$100," while he may still investigate the offering to determine the true value of the stock, he not unnaturally proceeds on the assumption that if the certificate says it is of the value of \$100, that value it ought to be unless otherwise expressly stated or understood, and that if it is not, the corporation issuing the share must be either more or less of a failure or more or less of a fraud.

Such judgment is not unjustified nor is it harsh. The public recognizes the fact that stock may rise in value if the enterprise is successful, or fall from its first value if the enterprise is unsuccessful, just as the greenback fell below par when troublous times beset the Government, but the share purports to be of a certain money value, and the public not unreasonably demands that at the time of issue at least this professed value shall be its real value.

This position of the public, in spite of the general knowledge of the actual conditions and the uncertainties of capitalization, will probably continue as long as the nominal value of stock is expressed in terms which apparently give it a definite value. It is a position that must be taken into account when capitalization is considered.

It is to be observed that the equality of corporate

assets and issued stock, though it may and should exist at the time of incorporation, does not, as already intimated, usually continue to exist thereafter. On the contrary the relations between the two change with every vicissitude of the business, the capitalization being a fixed amount only to be changed by formal procedure, while the value of the enterprise is a varying amount fluctuating with every success or reverse encountered in the course of business.

For instance, a partnership is incorporated for \$50,000, this being the actual value of the business at the time of incorporation. If the following year were a prosperous one, the net profits of the new company might perhaps amount to \$10,000. These profits, until withdrawn from the business, increase the company's assets by that amount. Then, while the capital stock is still \$50,000, the value of the enterprise is \$60,000, and the capitalization is no longer an exact measure of value. Or, conversely, this same company might experience disastrous reverses and lose half its entire assets. Then the value of the business would be but \$25,000, while the capitalization still stands at \$50,000, and again fails as a measure of value.

In quoted stock these variations between the value of the enterprise and its capitalization are supposed to be reflected with more or less accuracy in the market quotations. These quotations do indicate with precision the selling price of the stock, but they are of doubtful reliability and not to be trusted as an indication of the real underlying value of the enterprise. In an unquoted stock the relations between capitalization

and the value of the enterprise can be determined only by an investigation of the enterprise itself.

While the initial capitalization of an enterprise should be based on the values involved, close accuracy is usually impossible. Variations within reasonable limits, however, are not apt to be attended with serious results. In case of an over-capitalization of an enterprise to be financed, the promoters will find investors wary of the offering and be forced to increase the inducements. In case of an under-capitalization the same face value of the stock will probably have to be given for the needed funds as would be the case if the corporation were more justly capitalized, which is in effect paying more for the money. Of the two, if within bounds, a capitalization in excess of the present values is perhaps preferable.

It is also to be noted that usually in the incorporation of a new enterprise and frequently in other incorporations, the existing value of the enterprise is used only as a basis upon which to build. Future needs must be provided for, present necessities and requirements must be met, and as a result the capitalization actually fixed upon is far in excess of the immediate value of the enterprise.

For example, an inventor may have designed and perfected a new form of dry battery and be desirous of securing capital for its exploitation. The battery is not only available for all the usual purposes of a dry cell, but is of less construction cost and of longer life. The use of dry cells is large and is constantly increasing, and the value of the new battery, if the inventor's claims are correct, is considerable.

Under these circumstances the present value of the patents under which the battery is held might be determined with some accuracy and be used as a basis of capitalization. This would, however, be difficult, and in practice the inventor would usually get at the matter from a different standpoint, taking the amount of money needed for the exploitation of his patents as a rough-and-ready approximation of their value, or as a basis upon which to reckon their value. In the present instance he might deem \$25,000 cash capital as ample for the development and operation of the business and be willing to balance his invention against this amount of development money. This proceeding is not entirely logical, but is common in practice, the relation between the money and the invention being varied according to conditions and the estimation in which the inventor holds his patents.

In the case discussed, the enterprise being balanced evenly against the money, we have a total value for the financed enterprise of \$50,000, of which half goes to the inventor and half to the parties putting in the money. A capitalization on this basis would certainly be reasonable, entirely proper and on the general basis of value—this value not being that of the patents alone, but of the financed enterprise.

If the invention were exceptionally attractive the money might possibly be secured on the plan proposed—that is, on an offer of \$25,000 in stock for cash to the same amount. The idea of par for stock in a new enterprise does not, however, appeal to capitalists as a rule. Therefore, and particularly if the money is to be raised

among a number of people, a larger capitalization would probably be necessary in order to offer more attractive inducements.

If, however, the amount of stock to be offered for capital is increased, the amount of stock for the inventor must also be increased if his half interest is to be preserved. Usually the inventor insists on this, and perhaps a capitalization of \$75,000 would be decided upon, \$37,500 of which would be retained by the inventor and an equal amount be given for the money. The conditions then have caused the capital stock to be increased by \$25,000 without any increase of value in the enterprise.

It may be objected here that the capitalists are getting but one-half the enterprise in return for their investment just as at first, and that the increased inducements are therefore apparent only and are not real. This is true, but nevertheless an offer of \$37,500 of stock out of a total of \$75,000 for the \$25,000 of cash would be more attractive than the offer of \$25,000 in stock out of a capitalization of \$50,000, and would secure the needed money quicker; first, because of the inherent tendency of civilized man to attribute to stock a value equal to its alleged or face value, which gives the offering more attractiveness, and secondly, because of the practical advantages found in the larger stock issue—due somewhat, but not entirely, to this same bargain-counter tendency of human nature—in case of later sales.

In addition to the capitalization already decided upon, a further amount might be added to provide a reserve for future contingencies. Possibly \$25,000 of stock might be allowed for these future needs and the total

capitalization of the company would then be \$100,000, all primarily based upon the original enterprise valued, when financed, at \$50,000. The stock included for future needs would not, however, go out of the hands of the company until these needs arose, and until that time for all practical purposes the capitalization of the company is but \$75,000. The reserve stock would neither vote, draw dividends nor usually affect the company in any other way. It would, in fact, be only a possibility—stock to be issued if required, but until then non-effective, and for all practical purposes non-existent.

It may be noted in passing that the laws requiring full payment of all issued stock would, in the case of the company under discussion, meet nominal compliance through the very elastic value of the patents. Twenty-five thousand dollars of the stock might be properly issued full paid to the parties investing, in exchange for the equal amount of cash received from them. Fifty thousand dollars of stock would then be issued to the inventor in the same desirable condition in payment for the patents. Of this latter stock, \$12,500 would be turned over to the men putting in the money, thereby making up their full \$37,500, and the remaining \$37,500 would be retained by the inventor.

The \$25,000 of reserve stock might either be issued at this time, the same very accommodating adjustable value of the patents being utilized for its full payment, or might be held back to be issued later when needed. If issued at the time the patents were taken over, it would be nominally issued to the inventor in payment for these patents, and would by him be turned back to

the company as a donation. The only advantage in issuing the reserve stock at the time of incorporation is to secure its full payment by means of the patents. If this is done the stock is known as "full-paid" stock, may be sold at less than its par value if need be and will not carry the liabilities that accompany unpaid stock.

In some undertakings the rate at which stock must be sold is so low and the cost of selling is so great, that these sale requirements are the main considerations in capitalization and the real values involved are practically disregarded. This is often the case in mining enterprises when the property is capitalized far in excess of any existing values and the shares are then sold at a small percentage of their face, dollar shares perhaps selling at one, two and three cents a share. In such cases the value of the enterprise—and its capitalization for dividend purposes—may be approximated by a calculation based on the amount of capitalization and the selling price of stock.

For instance, if a mine is capitalized at \$1,000,000 and the stock is offered for sale at three cents for each dollar share, the amount received if all the stock were sold at this rate would be \$30,000, which therefore represents the value really put upon the mine by the owners at the time of this offering. In other words, the mine has been capitalized at an amount exceeding its present value by \$970,000. As, however, the matter is well understood by all parties and the general equities are preserved by the small price at which the stock is offered, the practice can hardly be reprehended. It is supposed to be a capitalization of possible values and

is considered more fully in the present volume under that head.

From the standpoint of capitalization, enterprises may be roughly divided into four classes, as follows:

- (1) Those in which the capitalization is not based on value and its amount is therefore a matter of but little importance or of absolute indifference.
- (2) Those in which the capitalization is based upon the present value of the enterprise.
- (3) Those in which the capitalization is based upon future values either probable or possible.
- (4) Those in which the value of the enterprise can only be determined by development and in which the amount of capitalization is therefore fixed by more or less intelligent estimates and guesses.

This classification can only be a rough grouping and many enterprises will be found that cannot be satisfactorily assigned to any one of the given headings, occupying either some intermediate position or partaking of the nature of two or more of them. The classification is, however, sufficient for the present purpose.

CHAPTER XVIII.

CAPITALIZATION NOT BASED ON VALUE.

Value is the obvious basis of capitalization. There are many cases, however, where other considerations prevail, the value of the enterprise having but little if any weight in the selected capitalization.

One frequent cause of this departure from the usual basis is the inchoate condition of the enterprise itself in which any accurate determination of value is impossible. An invention in its first stages, as discussed in a preceding chapter (Chapter XVI) is a common example of such an enterprise. Here the value of the enterprise is an unknown and, at that time, absolutely unknowable quantity. The device may be a failure or prove unpatentable and have no value at all. On the other hand, it may be largely successful and be worth hundreds of thousands of dollars. Manifestly the uncertainties are too great to permit of any just valuation.

Under such circumstances, if others are to be interested in the undertaking and it is to be incorporated, as is frequently the case, the capitalization must of necessity be fixed entirely irrespective of the values involved. Capitalization then merely serves to apportion the respective holdings of the interested parties and its amount is, in most cases, a matter of but little importance.

Such capitalizations are merely temporary and are

usually placed at some comparatively small figure to avoid the incorporating expenses and the fees and taxation involved in larger capitalizations. Their purpose is to carry the enterprise over from its condition of absolute indetermination to a point where some value has been demonstrated or can be ascertained. Then the enterprise may be, and usually is, recapitalized on the basis of value.

Somewhat allied to capitalizations of this nature are the temporary organizations quite common when large undertakings are to be incorporated. Such an organization is a small preliminary corporation formed for the purpose of securing the corporate name and holding the enterprise until the time comes when this enterprise may be taken up advantageously by the larger corporation. It is a temporary "holding" company to which the options, contracts and properties then in hand are assigned and through which the affairs of the enterprise are conducted until the proper point has been reached for the formation of the permanent corporation. Then, the purpose of this preliminary organization having been accomplished, it is merged in the larger corporation, or otherwise is dissolved and abandoned.

For instance, in the formation of the United States Steel Corporation, the company was first organized with a capitalization of \$3,000. This very modest capitalization endured for a period of less than six weeks, when the affairs of the "aggregation" having reached the proper point, the capitalization was raised at a single bound to over \$1,000,000,000,—the largest bona fide industrial capitalization in the world.

In cases of this kind the capitalization of the preliminary organization is again a matter of small importance. The whole arrangement is temporary and the capitalization is fixed at any convenient, but usually small amount.

Close corporations form another class in which capitalizations not based on value are frequent. Here there are but few people interested. All of these usually participate actively in the business, stock is not to be sold and there is no object in paying the fees, taxes and other heavy expenses incident to a large corporation. Therefore such corporations are capitalized at some nominal figure, the amount selected bearing no relation of any kind to the real value of the enterprise. The amount of capitalization in these cases is commonly a matter of indifference except in so far as the incorporating expenses and subsequent taxation are concerned, which, as stated, usually tend to fix this amount at a low figure.

An excellent example of this kind of corporation is afforded by a recently incorporated business handling a well known household preparation. For over thirty years this business was conducted as a partnership, the firm being composed of three equal partners and the annual net earnings averaging nearly \$12,000, while the assets were about \$6,000 exclusive of trade-marks and good-will, in which lay the great value of the business.

On account of some changes in the mutual relations of the partners—one of them retiring from the active management—and to secure the permanence of the business, incorporation was deemed advisable. The proper capitalization of the new company then came up for

consideration and it was soon seen that as between the partners this amount was absolutely immaterial. None of them expected or desired to sell stock, and no matter at what figure the capitalization was fixed, each would have his one-third of the total amount and thereafter receive his one-third of the profits as dividends. Obviously these dividends would be the same in amount—though not in percentage—whether the capitalization was \$1,000 or \$100,000. Accordingly the value of the business was disregarded and the capitalization fixed arbitrarily.

For some reason not divulged, the parties in interest decided that the capitalization should either be \$6,000 or \$60,000 and left the selection to their attorney, who promptly settled upon the smaller amount, and the company was thereupon formed with a capitalization of \$6,000, each party to the incorporation taking \$2,000 face value of the new stock.

The attorney's decision in favor of the smaller capitalization was based upon a general feeling of conservatism, and, more directly, upon a desire to avoid the heavier taxation that would have been incurred by the \$60,000 capitalization. The only objection that could be urged against the small capitalization lay in the fact that the dividends paid thereon—and necessarily shown by the details of the franchise tax report required of New York corporations—would be so excessive, amounting to 200 per cent. per annum, as to provoke comment and possibly arouse dangerous and unnecessary competition. At the suggestion of the attorney in charge, this difficulty was overcome by the distribution of the

major part of the profits as salaries. These salaries were undoubtedly excessive, but as each of the former partners received an equal amount, no one was injured and no one complained. It made no difference to them whether they received their profits in the form of salaries or dividends. Under the plan adopted the apparent profits or dividends were reduced to a reasonable figure, the corporation was organized and the business has since been conducted under the rather absurdly low capitalization of \$6,000.

The matter of keeping dividends down to a reasonable figure is occasionally of great importance and brings about another condition under which capitalizations, irrespective of value, are sometimes resorted to.

In many corporations, while excessive profits are greatly desired, excessive dividends are not. In some cases it is almost a business necessity that they be avoided. This is true where competition would be attracted, or where enmity, antagonism and perhaps undesirable legislation might be incited by unusually large dividends.

In such cases if but a few people are interested the salary plan can always be utilized to keep dividends down to a reasonable figure. When, however, a number of persons are involved, the salary plan is not practicable, and the real values are then abandoned and the capitalization fixed on a purely dividend-concealing basis. To accomplish this it is apparent the capitalization must be placed in excess of the real values. For instance, if a business is capitalized at \$50,000 and is paying thirty or forty per cent. in dividends on this amount, the dividends can be materially reduced only by

a liberal stock-watering. Probably the capitalization will be doubled, reducing the dividends to fifteen or twenty per cent. These dividends, while still liberal, would not be excessive for most commercial undertakings and would not be apt to attract attention or competition. If they were still too large to be safely published, the capitalization might be increased to \$200,000, reducing the dividend to the very reasonable figure of seven and one-half to ten per cent. The higher fees and taxes involved in an increased capitalization of this kind are looked upon as a justifiable and even necessary expense required by the conditions.

In cases of this kind, the increased capitalization, while primarily adopted to conceal dividends, is also frequently justified on the basis of profit probabilities, and the general subject is therefore discussed under that heading.

Capitalizations independent of values also occur occasionally as a pure matter of expediency, as, for instance, in the recent incorporation of a prosperous little publishing business. Here the value of the business was first taken as the basis for its capitalization, which was fixed at the sum of \$12,500. Before application had been made for a charter it was found that the trade standing to which the company was really entitled, or to which its owners thought it was entitled, would not be secured under the capitalization proposed. Thereupon the value of the business as a basis of capitalization was promptly abandoned and the amount of capital stock was arbitrarily and purely as a matter of business policy raised to \$25,000.

In this case it may be said that the difference between

value and capitalization was more apparent than real, since as a matter of fact but one-half of the nominal capitalization was issued, the remaining stock being held unissued to be sold for additional capital later or to be issued as a stock dividend if at any future time the increased value of the business should warrant such a step. The nominal capitalization was, however, twice the real value of the business.

CHAPTER XIX.

CAPITALIZATION BASED ON PRESENT VALUES.

(New Enterprises.)

The proper capitalization of a new enterprise well within the ordinary lines of business is a simple matter. For instance, a young merchant, having acquired in subordinate positions a thorough knowledge of some particular business, may decide that the time has come for independent effort and the organization of a company with himself at its head. Good-will does not exist, no unknown terms are involved, and the capitalization of the new concern is of easy determination. The cash or other property put into the new business represents the entire value of the enterprise and would be the obvious measure of its capitalization.

Or, if the young merchant excels those with whom he will be associated, either in experience, trade connections, or general ability, his superior qualifications and greater value to the business may perhaps be recognized by an allotment of stock in addition to that representing the actual cash or property invested by him. The capitalization will then be necessarily increased by the amount of this stock allotment.

In any such case the experienced party might be paid a larger salary in recognition of his value to the busi-

ness instead of an allotment of stock, but even then such salary, in part at least, might very properly be paid in stock, thereby relieving the strain upon the immediate cash resources of the young concern. Stock for such a purpose is usually issued to the recipients in the form of stock salaries—so much stock each month until a certain stipulated total is reached—the stock when issued becoming full paid by reason of the services given in return.

A somewhat similar arrangement is not uncommon when the services of some desirable party, such as a successful salesman, an expert engineer, or a capable superintendent or general manager, are to be secured and inducements beyond the ordinary salary must be offered. In such a case the stock consideration may be given in the form of a stock salary, or it is sometimes set aside under contract to be paid for by the party for whom it is reserved in a term of years or on easy instalments, or it may perhaps be given *en bloc* without restrictions at the time the party enters the employ of the company. Sometimes in the case of a manager, a stock bonus of this kind will be made conditional on a certain specified measure of prosperity being reached by the company within a certain time. It is then a strong inducement to effort on the part of the prospective recipient.

In any of these cases the amount of the stock bonus or donation is comparatively small, usually not enough to affect the capitalization materially one way or the other. Such stock payment is, however, legitimate without regard to its exact amount and is properly included

in a capitalization on the basis of values. It represents real value because the business, under the expert management secured, is worth more than would otherwise be the case.

When a corporation is formed to actually purchase a going concern, the capitalization is also, as a rule, easy of adjustment, being either fixed at the real values involved or based directly upon these. In this case, as far as the new corporation is concerned, the somewhat uncertain element of good-will does not enter. Good-will exists as to the business, it is true, but the price put upon the business includes this good-will, and the interested parties in considering capitalization do not go behind the agreed price. Usually the purchasing corporation will be capitalized at the cost of the business plus any operating capital and reserve deemed advisable.

When the transfer of the business is to be made, the parties who have the matter in hand usually either purchase the business and then turn it in to the corporation in exchange for stock, or they first organize the corporation, pay for its stock in cash and then take the funds so secured and purchase the business in the name of the corporation. The results are practically the same in either case. Or if the original owners are to be interested in the new corporation and agree to take part or all of the purchase price of the business in stock, the corporation will naturally be organized at once and the stock be issued direct to them in payment for the business.

Sometimes it happens that one or more of the parties interested, or perhaps an outside promoter, will secure

an option on a business at one price and then turn it in to the purchasing corporation at an increased price. Such an advance in price represents a direct profit to the promoter or other interested parties.

In any such case, the supposition is that the promoter has secured his option on the business at less than its real worth to the corporation and is therefore entitled to a profit on the transaction. That is, if the business were held under option by the promoter at \$45,000, it may be priced to the corporation at \$50,000 or more. If the proposition is accepted, the position taken by the accepting parties is that the price is not in excess of the real value of the business to the corporation and is therefore justified. The additional capital stock made necessary by this advanced price is then looked upon as a legitimate issue on the basis of actual value.

If the business purchased or held at \$45,000 is to be turned in to the corporation at \$50,000, the capitalization of the company will probably be fixed at this latter amount plus such stock as is needed to secure working capital. The necessary amount of this working capital is easily determined if the parties are experienced in the particular line of business. Frequently the only question is whether the amount of cash that can be secured for this purpose is sufficient. In the present case, \$25,000 in stock might be added for working capital requirements, making the total capitalization of the company \$75,000.

If the business were really worth the \$50,000 at which it was turned in, this value being justified by its

present condition and past profits, and if the business standing and reputation of the parties who are to manage the corporation is good, this stock provided for working capital should bring its par value.

If, however, the price of the business is high or the reputation of the parties in control is not of the best, this stock would probably be difficult to sell at any price, and unless taken by the interested parties themselves, would, if sold at all, sell much below its face value.

If it is anticipated that additional capital will be needed later, the capitalization will probably be increased still further at this time, the excess stock being reserved for issue when needed. The capital stock would then be \$75,000 plus the amount of this excess stock. Or the company might be capitalized at the exact amount needed at the time, and when the necessity for more money arose, this first capitalization be increased by the requisite amount of stock.

The first plan is usually preferred. It involves, however, heavier incorporating fees in the first instance and in many states additional taxation thereafter. There is also some little danger in carrying a stock reserve of the kind. It may be a temptation to extravagance on the part of the management, or it has occasionally occurred that those in control have sold such reserved stock at a figure below its value, making a private profit for themselves by such sale, or have sold it to parties with whom they are co-operating, thereby securing control.

Usually, however, such dangers are negligible; the larger incorporating fees have to be paid sooner or

later, whether the stock reserve be included in the first capitalization or be added when needed; the additional taxation is light, and, as a rule, any such reserve—if its necessity is reasonably apparent and not too remote—is included in the first capitalization. If not, and the capitalization must be increased later, considerable expense—mainly for legal fees—and trouble are involved, particularly on account of the necessity of securing the assent of all or a large portion of the stockholders, which is required in most states and which is occasionally difficult to obtain.

Sometimes the capitalization of a new enterprise otherwise simple is complicated by the necessity for payments to promoters. For instance, a marble quarry valued at \$50,000 as it stands is owned by parties who wish to operate the quarry, but lack the necessary cash capital, which they estimate at \$25,000. They are unable to raise this amount themselves and secure the services of some outside party or promoter to raise it for them.

In capitalizing under these circumstances, the amount of stock to be offered for the money is usually the first consideration. This would vary with the desirability of the investment. If the prospect of profits were sufficiently good, stock might be sold at par. Ordinarily it would have to be sold at less, probably much less, say, for instance, two for one, \$200 par value of stock being given for each \$100 of cash. This then would fix the capital stock to be given for the money at \$50,000, which, added to the value of the quarry, would bring the capitalization up to \$100,000. Then the compensation of the promoter must be considered. His

demands would vary according to circumstances, probably ranging—if paid in stock—between \$5,000 and \$25,000. If \$10,000 of stock were fixed as the promoter's honorarium, the capitalization would be brought up to \$110,000. To this would probably be added a reserve for contingencies, of say \$15,000, making the total capitalization of the company \$125,000.

If such a capitalization could be fixed in this way and stay "fixed," the matter would be simple. In practice, however, it will be found that the parties investing their money object to a direct allotment of stock to the promoter. They are willing to be "discovered" by the promoter, but do not care to pay for this discovery so handsomely, and therefore take exception to the promoter's stock, which, representing no material value, merely "waters" the capitalization and thereby directly diminishes the value of their interest. To remove this objectionable feature, the promoter's quota of stock is usually concealed in that retained by the owners of the quarry. In other words, the owners apparently retain \$60,000 of stock for themselves—this really including the promoter's fee—offer \$50,000 of stock for \$25,000 in cash and reserve \$15,000 of stock for future emergencies.

Such an offering is "ragged" and not well balanced, and it is also to be noted that under the general arrangement—if carried out—the owners will have but \$50,000 of stock out of \$110,000 actually issued, placing them in the position of minority stockholders. It is also to be noted that the men with money would look upon any odd amount of reserve stock, such as \$15,000, as "fair

game” and would probably demand that it be added to their stock as a condition precedent to investment.

To obviate these difficulties and to smooth out the general offering, the capitalization would probably be increased to \$150,000, of which \$75,000 would be retained by the owners, \$50,000 be offered for the money required and \$25,000 remain as a reserve, the owners providing for the promoter out of their stock. The investors would probably object to the somewhat scant provision for their interests and demand a larger quota of stock, but might perhaps be “pacified” by means of stock preferences or other concessions which would not disturb the general adjustment. Usually, however, they would insist upon a full half interest for their money.

If the capitalization of \$150,000 is adopted and the arrangement carried through, the issued capitalization of \$125,000 represents an actual property value of but \$75,000. The bonus of \$25,000 given for the money may be regarded as based on value, because of the immediately increased value of the enterprise when this money is secured, as may also the payment to the promoter, which represents the accomplished connection between the property and the capital required for its operation.

Such payments to promoters are usual and necessary and if not carried to excess are legitimate. They can only be looked upon as a part of the consideration given for the money—that is, in the present instance the \$25,000 of cash actually secured cost the enterprise \$60,000 of its stock. The only justification on the basis of value for this capitalization is the fact—if it be a fact—that the financed enterprise is worth the whole

amount at which it is capitalized. This proposition could be proved or disproved only by the subsequent history of the undertaking. It is really a capitalization on the basis of prospective profits.

Frequently the most difficult point connected with the financing and capitalization of a new enterprise, when out of the established lines of business, is to decide what amount or proportion of the capital stock must be offered for the necessary money. This will vary with the conditions.

For instance, an inventor has devised an attachment to the ordinary photographic camera by means of which the convenience of the instrument is much increased. His invention is worked out in detail, is fully patented, has been tested in actual use and better still, cameras of the new design have been actually made and sold and are now in use, showing that the idea is good and that it has a field for exploitation.

In this case it is possible for the inventor to manufacture and sell his improved camera with his present equipment. This, however, is so crude and inadequate, and the inventor's means are so limited, and his output is therefore so small and at such an excessive cost, that the profits of the business so conducted would hardly support him. Under such conditions the enterprise could not build up from its own profits, and additional capital must be secured if the business is to prosper.

Five thousand dollars will equip a modest little factory and start the business on such a scale that its successful operation is, under good management, reasonably certain. The inventor, therefore, has decided to or-

ganize a corporation and dispose of sufficient stock to secure this needed \$5,000, and the question of capitalization is now under consideration.

In this case and in those similar cases there is no object in capitalizing beyond the amount actually necessary to represent the inventor's interests and to enable an attractive offer to be made for capital. The business can build up on its own profits. The present necessities are all then that need be considered and the problem narrows down to the amount of stock that must be offered for the required \$5,000, and in connection therewith the amount of stock that the inventor may reasonably expect to keep for himself. These two amounts will form the total capitalization of the corporation.

Few as are these points, the problem is a somewhat difficult one. The enterprise is not one which offers any promise of great wealth to the interested parties. It has merit but only sufficient to build up and sustain a good business under a moderate capitalization, modest expectations and good management. The financed undertaking might very fairly be valued at \$15,000. Putting the business itself at \$10,000, the company would theoretically be capitalized at \$15,000, of which amount \$10,000 should go to the inventor and \$5,000 to the capitalist. This would be a fair and moderate capitalization on which excellent dividends could undoubtedly be paid, and considering the effective condition of the invention and the enterprise, would not be unreasonable.

In practice, however, the inventor would have to be a hypnotist of the first order to get his money on any such "bed-rock" basis, and as he does not possess abil-

ities of this kind, a more liberal offer will undoubtedly be necessary.

Probably the inventor will compromise on a capitalization of \$15,000, one-half going to the man with money and the other half to the inventor. Under this proposition, if the inventor can find the right man, he will probably get the money. If not, he may have to offer more attractive inducements and will then capitalize at \$20,000 or \$25,000, one-half going to the man with money and the other half to the inventor as before. The increased inducement to the man with money is obviously more apparent than real, but nevertheless the larger offering is more apt to secure the money.

In this case, if the inventor finds it necessary to secure the assistance of a promoter in obtaining his money, the capitalization is likely to be larger, and the man with money will then take half and the inventor take what the promoter leaves him. If the promoter were conservative, the enterprise would probably be capitalized at from \$20,000 to \$25,000, of which the man putting in the money would get one-half, the inventor about one-third and the promoter the remainder. If the promoter were not conservative, the enterprise would probably be capitalized at from \$50,000 to \$100,000, with a generous reserve in the treasury to give an air of conservatism and a liberal distribution of the remaining stock to interested parties, and particularly to the promoter.

In a matter of this kind \$20,000 or even \$25,000 could hardly be deemed an excessive capitalization. The company will probably pay dividends on that amount, and

even if it should not do so, the consequences would not be very serious, particularly if the enterprise were kept in the hands of the original parties. Even if others were asked to participate, the enterprise is so small, so open and so within the standards of ordinary business judgment that, barring misrepresentation, the parties purchasing stock could hardly have ground for complaint of the capitalization.

No definite rule can be laid down as to the offer that must be made to secure money. It will not only vary with the enterprise but will vary in the same enterprise according to the method adopted for securing money.

For instance, a new and reasonably attractive invention valued in a financed condition at \$200,000, may require \$25,000 for operating funds. If the owners cannot provide these funds, stock must be given to the capitalist to such amount as will secure this money, the balance of the stock remaining as the property of the owners. In such a case the capitalization might very well be placed at the value of the financed enterprise—\$200,000.

If the larger investors are appealed to, it would, unless the enterprise were unusually attractive, be necessary to give \$100,000 in stock or even more for the required \$25,000. If, however, the investment is apportioned among a number of smaller investors, each one putting in a few hundred or a few thousand dollars, it is probable that from \$50,000 to \$75,000 face value of the stock or even less would be quite sufficient to get the money.

Under the second plan the stock given for the money would be at least \$25,000 less than under the first.

Against this, however, must be set the additional trouble of reaching smaller investors. In either case, if the services of promoters were necessary, the cost of getting the money would be increased by the amount given these promoters, the value of the owner's interest diminishing as the amount of stock given for the money increases.

As the nature of the enterprise departs more widely from the conventional and established, the difficulties of capitalization increase on account of the difficulty of determining values.

The value of a new typewriter, for example, can be estimated by experts; the worth of a new engine would not be hard to determine, nor would the valuation of an improved steam gage be difficult. Standards of comparison exist for all these and their approximate value and the capitalization to be based upon it are easily ascertained.

So also in an enterprise of a definite character, such as a coal company formed to develop and operate certain properties. The cost of the properties is known, the expense of opening them and equipping the mines can be quickly and accurately determined by mining engineers, the necessary operating capital is even more easily estimated and the proper capitalization on a strictly investment basis is the sum of all these, with perhaps a reasonable emergency margin added.

If, for example, the coal lands to be acquired by the new company were priced at \$75,000, the expense of equipment and development to a self-sustaining basis be estimated at \$40,000, and the working capital fixed

at \$15,000, the aggregate of these three, or \$130,000, would, generally speaking, be the proper capitalization of the enterprise. If any subsequent enlargements or improvements or additional equipment were contemplated, too expensive to be provided for out of current profits, the capital stock might be increased to provide for these additional funds, say to \$150,000, or even to \$200,000, the excess stock being held unissued until needed.

Such a capitalization is on a strictly investment basis and the stock should be sold at par and for cash. If the mine were successful, the enterprise would pay handsome and even excessive dividends. Usually such an enterprise would be capitalized on the basis of these probable profits as discussed in Chapter XXI of the present volume.

The capitalization of an awarded contract is another example of a comparatively easily determined capitalization. Here, let us assume, a contractor, after securing a harbor dredging contract, wants money to carry out his undertaking. He is an experienced contractor, and has undertaken the work at the rate of twenty-two cents a cubic yard. Having no plant of his own, there are two courses open to him—to equip and operate his own plant or to sublet the contract, probably to two or three different parties. He finds he can sublet at an average price of eighteen cents per yard. He can remove the material himself at a less price if he equips his own plant. He would, therefore, be governed by the particular conditions as to whether to operate it himself, or sublet and merely supervise the work of his sub-con-

tractors. If he decides to sublet, the amount of capital needed for supervision purposes is so small that ordinarily he would provide it from his own private resources, or obtain it on favorable terms by loan or through some special proposition to his friends, and a capitalization would not be necessary.

If, however, he decided to undertake the work himself, a very considerable capital would be required, ranging anywhere from \$50,000 to \$250,000 or more, according to the extent of the undertaking. A contractor of experience would very easily estimate quite accurately the amount necessary for plant and equipment, also for operating and emergency funds—say \$200,000 for all. To this in fixing the capitalization of his company he might add a fair amount of stock as his own profit on the transaction, the amount varying with the conditions. If the contract is a good one, and his personal services are to be devoted to the work, \$50,000 face value of the stock of the company in addition to a salary would not be an exorbitant profit for the contractor. This would fix his capitalization at \$250,000, provided he can dispose of the \$200,000 of stock at par.

If he does this, his own stock apparently represents a net profit of \$50,000 at the first "clatter out of the box." Really it does nothing of the kind. All his stock represents is a twenty per cent. interest in the undertaking. It is true that the company has, if financed on the terms suggested, \$200,000 cash, and his stock has therefore an actual immediate value of twenty per cent. of this, or \$40,000, but, outside of actual fraud or bad faith, he cannot realize on this

value except by making the enterprise a success, and the value of his holding will depend entirely upon the manner in which he works the enterprise out.

If he makes a failure of it, his stock will at the best only represent an interest in a depreciated plant and a discredited company. If he makes a success, it will bring him substantial profits on the particular contract and leave him a twenty per cent. interest in a first-class operating company of recognized position and standing.

In order to prevent any profits in a case of this kind to the contractor or promoter, unless he is successful, the stock for which cash has been paid is frequently issued as preferred stock with a fixed and also a participating dividend and a prior interest in the company property. Then unless successful the contractor derives neither profit, property nor professional reputation from the undertaking and his stock is utterly valueless. This arrangement is, under most circumstances, very fair to all parties and, if the contractor is acting in good faith, should not be objected to by him.

A contract of the kind cited might very properly be capitalized at a much higher figure on the basis of probable profits. The illustration is discussed further in Chapter XXI, "Capitalization Based on Profit Probabilities."

CHAPTER XX.

CAPITALIZATION BASED ON PRESENT VALUES.

(Going Concerns. Good-will.)

When a going concern is incorporated, its capitalization presents a problem not found in a new enterprise, viz., good-will. This good-will is the profit-producing power of an established business beyond mere interest and replacement returns on the material value of the capital and property invested. It is a belonging of the business, but an intangible and sometimes very evanescent belonging, possessing a value fluctuating according to its volume, its stability and the firmness with which it is linked to the particular business. It usually represents an investment already made, of time, money, attention or general business ability, or it may come without effort from purely fortuitous circumstances. In any case, provided only that it can be held, it is an asset of value to be included in any capitalization of a business just as are the goods, the real estate or any other belongings.

It is obvious, however, that when the good-will is of such a nature that it will not stay with or follow the business, it is valueless to a purchaser of that business. From this negative value good-will runs up the scale until in some lines of business we find it is the most valuable asset and sometimes the sole asset of material value.

A good-will not linked to the business in which it is enjoyed and either not following it at all or only to a limited degree is usually a good-will personal to some individual connected with that business. In such a case its existence is due to or depends upon the popularity, acquaintance, connections or other conditions peculiar to the party around whom it revolves. Trade is perhaps brought to the establishment by friends of this party who will go far out of their way to patronize his concern, or perhaps he has influential relatives who use their position for his advantage, or possibly he is such a "jolly good fellow" that people drop in just for the purpose of enjoying his society. Or it sometimes happens he is such an expert in his line of business that people will come from far and near because they get better work or better goods from him than from others.

In any such case, should the party who is a "drawing card" leave, a very limited proportion of the trade will probably remain with his successor, but the greater portion will follow the individual upon whom it is centered, or, if he is no longer accessible, will scatter and be lost to the particular establishment. Such a good-will is a most valuable asset to the party to whom it belongs, but is of little or no permanent value to the establishment with which he is connected unless this individual is directly interested in its business or can be firmly held. If this is not the case the good-will is not an asset that can properly be considered in the capitalization of the concern.

The good-will of most professional businesses, in places where competition exists, is largely of this na-

ture. Many of the medical and legal practices in the City of New York are worth up into the tens and even hundreds of thousands of dollars annually. Their value, however, rests almost entirely in their good-will, and if a practice were sold, this would not bring a tithe of the amount a good-will of equal productive power would in other lines of business.

To such an extent is this true in the law that practices are seldom, if ever, sold, simply because the goods cannot be delivered. The only way in which the matter can be approached with success is by the introduction of a partner or associate who by slow degrees works into the confidence of the old patrons and gains a knowledge of their personality and business, which will, if the new man be of the proper calibre and general qualifications, eventually lead to the inclusion of himself within the precincts of the existing good-will.

In medical matters, good-will can be transferred with more success—though the transfer is difficult and wasteful—and as a consequence the sale of practices is much more common in medicine than in the law. Even here the best way to approach the practice is by a gradual system of transfer through the medium of a partnership. Nevertheless, if a competent stranger buys the business outright he has the first chance at the practice, and if he be well qualified and skillful, will probably hold the greater portion.

In this country the sale of medical practices is not so common as to have established any general rule for the estimation of their value. In England, where the good-will of a professional practice is a much less fragile

article on account of the more firmly established conditions and the greater reluctance of the people to change, the value of a medical practice generally ranges from one to two years' annual receipts; that is, if the practice brings in \$5,000 a year, its selling price is fixed at from \$5,000 to \$10,000, according to the conditions. The element of personal services rendered enters into a transaction of this kind in such a way as to obscure the actual value of the good-will, but after making allowance for this, it is obvious that its valuation is but a fraction of what it would be if more firmly held.

In commercial circles the conditions are usually very different. Here, in some cases, good-will constitutes the chief asset of a prosperous business and is practically the only factor to be reckoned with in its capitalization. To this class belong many of the businesses based upon proprietary articles. In these the good-will, as carried by the trade-names and the trade-marks, is often valued at hundreds of thousands of dollars, while the property assets are comparatively insignificant, and formulæ equally as good as those by which the articles are prepared could in many cases be secured for little or nothing.

Take, for example, "Pond's Extract," to which reference has been made in a preceding chapter. Its composition is well known. Practically the same extract under other names is manufactured by half a dozen different concerns, but people are used to the name "Pond's Extract" and will have none of these others. Or take such a well-established article as "Sapolio." It is unquestionably a very excellent preparation for its

purposes. An equally good and efficient preparation could, however, be compounded by almost anyone versed in the art. The formula is a mere incident—a very important one, a very necessary one, and one at times very difficult to obtain, but still merely an incident. The article must have merit if the business is to be worked up and sustained, and it must be of a suitable nature, but beyond this its composition is a matter of much indifference—provided only that it is inexpensive. An expensive compound would not leave the very liberal margin for advertising and other publicity work—amounting in the case of sapolio, it is said, to not less than \$1,000 a day—that is mainly instrumental in the building up of such a good-will.

Given a formula, though it be satisfactory in every way, and the first step has hardly been taken. Years of arduous effort, ingenious advertising and heavy expense are requisite before a good-will such as that now enjoyed by sapolio can even be approximated. Nor is this expense due to the cost of stock, preparation, etc. All this is a mere item. The real expenditures are found in the advertising, the general pushing and the consumption of very capable brain matter, which, if properly and perseveringly continued, finally lead up to the monumental good-will of the successful proprietary businesses. Indeed, it may be said that with a fairly good article of general use, capable of being produced cheaply and sold at a fair price, with plenty of money for pushing and with the intelligent and continued use of this money, success, and large success, is a mere matter of course. The fairly good article is not difficult to

secure; at times much difficulty is experienced in securing the requisite money and the experienced intelligence requisite for success.

The same firm that controls sapolio well illustrated the general principles involved in building up the good-will of a proprietary article by their more recent exploitation of "hand sapolio." In its general composition the material is but little if anything more than the old "sand soap" which has been in use for generations. It is, however, a meritorious article of general use and capable, it seems, when judiciously presented, of being sold at retail for ten cents a cake—a price affording the handsome margin of profit essential in an exploitation of this kind. The concern had then a good article. They already possessed the other two requisites for success in this line—money and business ability—and the manner in which they have used the combination to make "hand sapolio" a household word, and, it is fair to presume, a financial success, is too well known to require discussion.

Such a good-will is carried entirely by the trade-mark and trade-name. The original owners of sapolio might withdraw or die, but given reasonable business ability in their successors, the business would go on utterly regardless of their absence. Or the trade-mark and trade-name might be sold and the good-will would promptly follow these symbols to which it is linked. In such a case its value, as represented by these names, can be estimated with the same accuracy as any other property asset and is as justly included in capitalization.

Between the extremes, where good-will is everything

and where it is practically nothing, there is a varying scale of changing relations and it is apparent that the value of the good-will of any particular business must be estimated and determined by the nature and conditions of that business.

It should always be borne in mind, however, that good-will is a peculiar and often unreliable asset. In event of the final liquidation of an ordinary commercial undertaking, the stock, the fixtures, the accounts and the other material assets have an intrinsic value bearing at least some approximation to the value at which they are carried on the books of the concern. The good-will on the other hand—save in case of a trade-mark or some equivalent—has no value that can be realized but scatters and is lost.

On account of this evanescent, intangible and somewhat uncertain nature of good-will in the ordinary business, it must in any conservative capitalization be reckoned at a figure much below its apparent or producing value.

The capitalization of good-will involves no peculiar difficulties. In economic discussions it is sometimes contended that good-will should not be included in capitalization at all, but that this latter should be based on the actual material values of the business alone and be fixed at the amount which would be sufficient to replace these material values if they were destroyed. On this basis the total capitalization of a proprietary business bringing in profits of perhaps half a million dollars each year might be a mere fraction of the earnings for a single year.

In practice, however, no such academic considerations obtain, and good-will as a rule, though not tangible, is regarded as an asset of the business just as is its stock, its bank accounts, its office equipment or its realty, and is valued in any capitalization of the concern with as little hesitation. The price placed upon such a business when it is to be sold will, as a matter of course, include good-will, and so also will the capitalization when it is incorporated.

The capitalization of good-will is almost always an important feature when a business which has been conducted under the partnership form is converted into a corporation with the old partners as the stockholders of the new company. Here, if proper books have been kept, the capitalization or the basis of the capitalization for the new company has been practically fixed in advance. All that is necessary is to balance the partnership books, take the present worth of the business as shown thereby, add to this present worth a fair valuation for the good-will of the old concern, and the result is in most cases the proper capitalization. The corporation is then formed, the stock of the new company is divided among the partners in proportion to their respective interests in the old business and as far as the capitalization and its distribution are concerned, the matter is at an end.

If the new company is composed of the old partners and no new members are to be admitted, the importance of including the good-will or of valuing it accurately is not at first sight always apparent. If instead the capitalization were based on the actual property

values and the stock distributed among the partners, each would have his proportionate interest, securing to him his proper status in the new company and his proper proportion of its profits, and this would seem to be all sufficient.

This is true so long as the business remains in the hands of the old partners without change. It is then a close corporation, as discussed in a preceding chapter, in which the capitalization is a matter of small moment, frequently fixed arbitrarily at some convenient figure and serving merely as a means of apportioning interests.

If, however, there is any probability, either immediate or remote, of new members being taken in, or of stock being sold, the capitalization of the business at its real value immediately becomes a matter of importance. Even when such changes are not contemplated, there is always the possibility that one of the original partners may die or become financially involved, necessitating the sale or other disposition of his stock, when the amount of capitalization again becomes a matter of importance. In any case, if stock is to be sold, no matter whether from intent or necessity, a deficient or under-capitalization will be found embarrassing and distinctly disadvantageous.

A reason for this is not hard to find. If the company were over-capitalized the matter could easily be explained to the purchaser of stock. Indeed, this is just what he is anticipating, and he would very cheerfully agree that the price of the stock should be less than its face value. It is, however, usually very difficult to convince him that the company has been under-capitalized,

and that he should therefore pay more than its face value for the stock. He may be convinced, perhaps, that such is the case, but as a rule, even though the under-capitalization is patent, it will be found that the prospective purchaser of stock is insistent on admission on the basis of actual capitalization, and not on the basis of the larger values claimed by the partners to exist. This being true, and the good-will being a valuable property belonging to the business, it should be valued and included in the capitalization with the same care as is given any other asset.

In a business of long standing the valuation of this good-will is not usually a matter of difficulty. The books of a hardware business show, we will say, an actual present worth in material values of \$45,000. The books also show that for the past ten years the average annual profits, after making all deductions for fixed charges, except interest on the investment, have averaged \$10,000, of which \$4,000 has been withdrawn by the partners on salary account and the remainder either divided amongst the partners or left in the business.

Under any ordinary circumstances the business would be expected to do at least as well and probably better in the future. If the salaries in the incorporated business were fixed at \$4,000 in the aggregate—the same sum as before drawn under the partnership—the average annual gains would amount to \$6,000 after payment of all expenses and allowances. This \$6,000 represents the net profits—the producing power of both the invested capital and the good-will of the business.

From these net profits, six per cent. on the invest-

ment amounting to \$2,700 might be deducted, leaving a balance of \$3,300 of profits to be credited to good-will. On account of this intangible and somewhat illusive nature, the valuation of good-will must be determined on a much more conservative basis than would obtain in more material values. In the case under discussion it might be considered that good-will should produce twenty per cent, annually, and on this basis its value would be \$16,500. As a matter of extra precaution this might be scaled down to \$15,000, which, added to the \$45,000 of material values, gives a total capitalization for the entire business of \$60,000, on which it could pay an annual dividend of ten per cent.

In ordinary practice, however, no such separation of earnings would usually be made, certainly not in a comparatively small business, such as that under discussion. Here if ten per cent. was considered a sufficient annual dividend for the business to pay, its capitalization would be fixed on that basis. As the net profits are \$6,000, this by a very simple calculation places the proper capitalization of the company at \$60,000. As the property values of the business are \$45,000, this amount deducted from the total capitalization leaves \$15,000 to represent the value of the good-will.

In the capitalization of large enterprises the common stock is frequently based directly upon and represents the good-will. In such cases preferred stock is first issued to the full value of the material assets of the undertaking. The dividend to be paid on this preferred stock is then deducted from the total net earnings, the balance left representing the earnings of good-will. From

this is determined the value of the good-will, and common stock is then issued to its full amount.

For instance, if the total estimated net earnings of a concern to be capitalized are \$3,000,000 per annum and the property values involved are \$20,000,000, preferred stock is issued to this latter amount. If a seven per cent. preferred dividend is to be paid, its amount—\$1,400,000—is deducted from the \$3,000,000 of earnings, leaving \$1,600,000 of annual profits to the credit of good-will.

This good-will is to be represented by common stock, its amount being fixed by the dividend rate decided upon. If the common stock is to have an eight per cent. dividend, a simple calculation will show that the \$1,600,000 of profits will pay eight per cent. upon \$20,000,000, which is therefore the amount of common stock to be issued. The total capitalization of the concern will then be the total of the preferred and common stocks, or \$40,000,000.

For instance, in the capitalization of Sears, Roebuck & Co., the mail order house of Chicago, some ten years ago, the material assets turned into the new company are stated roundly to have had a net value of not less than \$10,000.00. The net profits for the preceding year, as stated by the financial agents of the company, were \$2,868,061.31. The usual custom of issuing preferred stock to represent the tangible assets and common stock to represent good-will was followed. This gave \$10,000,000 of preferred stock as the first item of the new capitalization, to which is assigned a seven per cent. cumulative preferred dividend, requir-

ing for its payment \$700,000 annually. This being deducted from the annual net profits, \$2,168,061.31 remains representing the producing power of the good-will. Common stock to the value of \$30,000,000 was then added to the capitalization to represent this good-will, which is therefore capitalized on the basis of between seven and eight per cent.

The total capitalization of the company, which it is fair to presume was so determined, is \$40,000,000, of which \$10,000,000 is a seven per cent. cumulative preferred stock representing the tangible property values, and the balance of \$30,000,000 is common stock representing the good-will or the net earning power of the business after payment of the seven per cent. interest rate on the material values involved. The fact that the company has paid dividends regularly since its incorporation, that on January 2 of this year its common stock was selling at 184, and that still more recently a stock dividend of \$20,000,000 has been declared, based upon accumulated earnings, would seem to show that the original capitalization was justified.

The capitalization of the United States Steel Corporation was reached in much the same way. Preferred stock and bonds were issued to the full value of the material assets. Common stock was then issued to represent the good-will, the amount of this common stock being such that, according to Wilgus in "A Study of the United States Steel Corporation," it would have received about seven and one-half per cent. dividends if the estimated profits had been maintained.

In the capitalization of most of these large combina-

tions, such as the United States Steel Corporation, the problem is complicated by capitalization of not only the existing good-will, but to a certain extent at least of the anticipated good-will. That is, the expectation of increased profits is represented in the capitalization. This is justified mainly on the basis of the economies and resulting greater profits incident to the combination. If such economies will really be effected and the resulting profits are capitalized conservatively, the proceeding is proper. Frequently, however, as is shown by the existing conditions of many of the larger capitalizations, the practice was carried far beyond the bounds of conservatism.

At times the capitalization of large combinations is carried so far as to become fraudulent. If we are to believe the allegations of its receiver, the collapsed asphalt trust which occupied the popular attention some years since, was a capitalization of this nature. Here the properties combined were secured by the promoters of the enterprise under option or contract and were in many cases turned into the trust at two and even three times the prices at which they were secured by the promoters. The fraud in this case was upon the public, to whom the highly watered stock and unsecured bonds of the combination were sold under the general statement and understanding that the enterprise was capitalized on a conservative and legitimate basis. The disastrous failure that resulted showed that it was not.

In the ordinary business undertaking, no such "skyward" capitalizations obtain as in the large combinations of the country. In most of these larger enter-

prises there are reasons, not remotely connected with profit-taking, for capitalizing to the utmost limit of possible dividend-paying power. These do not exist in the ordinary going concern and, as a rule, the capitalizations of these latter are much more conservative. There is no fixed rule, but a safe capitalization would ordinarily demand that the capital stock added to represent good-will should produce much more than seven and one-half per cent.

CHAPTER XXI.

CAPITALIZATION BASED ON PROFIT PROBABILITIES.

Much allied to the capitalization of good-will in a going concern is the capitalization of profit probabilities of a new enterprise. The difference between the two lies in the somewhat material fact that good-will is the proved earning power of the enterprise as shown by its past history, while profit probabilities are merely expectation. The one can be capitalized with considerable accuracy. The other can only be approximated and is apt to be very much overestimated.

In enterprises of a certain class, and more particularly in those of a speculative nature, this capitalization of profits is usual and expected, and, within bounds, a legitimate proceeding.

For instance, the necessary capitalization of the coal property discussed in a preceding chapter is \$130,000. If, after reservation each year of a sufficient amount to provide for maintenance, depreciation and the other fixed charges, including a sinking fund against the final working out of the property, the estimated profits will pay a dividend of fifteen or twenty per cent. on the invested capital of \$130,000, the capitalization of the enterprise might be increased up to even twice the

necessary amount, or to a total of \$260,000. On this the enterprise will, if successful as anticipated, pay annual dividends of seven and one-half to ten per cent. Such a dividend should give the stock a par value and bring to the original owners a "good-will" profit incidental to the successful operations of the mines, of one hundred per cent. on their investment.

If the capitalization were kept at the original figure of \$130,000, the dividends, profits being the same, would be far above any normal rate of interest. As a consequence, the stock would sell above par and the owners secure their good-will profit in this way. To equal the good-will profit of the larger capitalization, however, this increased price would have to be at least 200, *i. e.*, \$200 for each \$100 share, and this price would not ordinarily be reached on the assumed dividends of fifteen to twenty per cent. In other words, a stock paying seven and one-half per cent. dividends may, under proper conditions, sell at 100 or par, but a similar stock paying fifteen per cent. dividends will not usually bring 200, or twice par. Hence, if the original owners contemplated future sales of stock and had any real basis for their belief in the earnings of the property, the increased capitalization would be good and legitimate business. From one point of view the stock is watered to the extent of \$130,000, but such watering under the supposed conditions and with a properly safeguarded sinking fund, is legitimate and fully justified. If the dividends are paid, it is merely a capitalization of values prior to or in anticipation of their development.

Or as somewhat differently expressed,* "If an enterprise were capitalized at such a figure, say \$200,000, that it could earn and pay a regular annual dividend of six per cent., its stock should sell readily at par, or 100. If its capitalization were reduced one-half, namely \$100,000, so that its regular annual dividend became twelve per cent., the stock having twice the earning power, and representing the same corporate property, should, theoretically, sell at twice par, or 200. As a matter of fact it would do nothing of the kind, ordinarily bringing from 175 to 180 according to circumstances, and showing the 'cashing' value of the smaller capitalization to be from ten to twelve and one-half per cent. less than that of the larger. That is, the smaller capitalization would involve a loss on the sale of the entire capital stock of from \$20,000 to \$25,000. As long as this is true, enterprises will be capitalized on their earning capacity rather than on their actual immediate value."

In any such case of advance capitalization, its justness can only be determined by development. It is in the first place founded on the judgment of the parties by whom it is fixed and the event only can prove or disprove the correctness of their judgment. If the enterprise pays fair dividends on the capitalization, they are justified. If it does not, they are shown to be in error and the capitalization is an over-capitalization.

The probabilities of profit might also be used to increase the capitalization of the dredging contract, discussed in connection with the coal mine proposition

Conyngton on Corporate Organization, page 75.

just considered, in a preceding chapter. In this enterprise the capitalization on the basis of actual values was fixed at 250,000, of which \$200,000 went to the men financing the undertaking and \$50,000 was retained by the contractor to represent his interest in the undertaking. If the matter were to be kept entirely in the hands of the original parties, there would be no object in capitalizing at any higher figure. If, however, there was a probability that stock would be sold, or in any event if the undertaking extended over a considerable length of time, capitalization on the basis of probable profits would be advisable and would usually be adopted. The prospects for profits in such an undertaking are good and the capitalization would very probably be put at double the proposed amount, *i. e.*, \$500,000. On this basis there is a clear \$250,000 of capital stock awaiting profits for its justification. If the expected profits are made, the capitalization is conservative. If they are not made, it is an over-capitalization.

In capitalizing enterprises founded upon inventions, the anticipation of earning power is customary. Any close estimate of these anticipated profits is, of course, impossible and in such cases the earning power of the enterprise as a whole is estimated as accurately as may be, the results are discounted by a safe margin and the capitalization is based on the prospective returns so determined. This capitalization must be sufficiently large to provide for all operating, sinking and other required funds, any stock reserves that may be deemed necessary for future emergencies, and such

additional stock for the inventor and his associates as will fairly represent the value of the invention or of their interest therein. All these requirements will have due weight in determining the actual amount of the capitalization.

For instance, a new sewing machine is invented. It has important improvements over existing machines, and, as conservatively estimated, after due provision for all operating and sinking funds, fixed charges, etc., will pay a ten per cent. dividend upon \$750,000. Some \$250,000 in cash is needed for the operations of the business and perhaps \$25,000 in cash is demanded by the inventor in addition to a substantial stock interest.

The capitalization of such an enterprise would probably be in the hands of the parties who are to finance it. They might fix the capital stock at \$750,000. One-half, two-thirds, or perhaps more, say \$550,000, will be given for the money, the exact amount depending upon the desirability of the invention, the ease of the money market, and the persuasive ability of the promoters. The inventor would then be given his cash and his stock, this latter perhaps amounting to \$75,000. Any agreed reserve of stock, say \$50,000, would be left in the treasury, and the remaining stock, \$75,000, would be retained by the promoters if the enterprise is financed through promoters.

As this compensation for promoters would be deemed rather small, they would probably prefer to capitalize at \$1,000,000, increase the amount given for the money to, say \$650,000, increase the amount for the inventor, if he could not be persuaded to take less,

to \$100,000, increase the reserve to \$100,000 and then retain the balance of \$150,000 for themselves. The average promoter would consider this a very moderate payment for promotion.

The capitalization of this same enterprise might have been determined from a different standpoint. The amount of stock necessary to secure the needed cash might have been estimated, the amount for the inventor settled by agreement, any reserve decided upon, and the prospective returns then calculated with careful accuracy to determine the amount of additional capital the enterprise would stand—this additional capital inuring to the promoters as their profits.

If in the case mentioned the inventor had friends to whom he could go direct and secure the needed money, thereby eliminating the promoter, the capitalization would probably be attained in much the same way, but with a different disposition of the proceeds. The capitalization would perhaps be fixed at not more than \$750,000. Of this amount the men with money might take two-thirds, set aside \$100,000 to \$150,000 for reserve and turn over the remainder to the inventor.

When we come to the capitalization of enterprises founded upon or including franchises among their assets, the question of profit probabilities arises in a different form. Such enterprises are very numerous and the proper basis of capitalization is a matter of much discussion—the point at issue being whether the value of the franchise is properly included in the capitalization or whether this latter should be confined strictly to the material property values of the undertaking.

The difficulty in this case seems to arise from the practice that has prevailed in this country of giving these franchises as a free gift; usually as a donation for the benefit of the parties to the enterprise, or as an inducement to secure the construction of some quasi-public work or utility, or as a tribute to the influence of money or the power of politicians. Sometimes they are stolen with more or less directness, but generally they are obtained by means not so liable to lead to subsequent disagreeable consequences.

As to the ethics of the question involved, nothing need be said—it is beyond the province of this volume. As to the practical side, it would seem just as legitimate to capitalize a valuable franchise as to capitalize any other property pertaining to the enterprise. The undertaking is to be capitalized as a whole and the franchise is an integral, inseparable and usually a most valuable and essential part of its possessions.

For example, the Philadelphia authorities a decade or so ago granted a franchise—broad in extent and liberal in its provisions—to the Union Traction Co. for the use of the city streets for trolley purposes. Immediately thereafter John Wanamaker, who had opposed the grant, offered \$2,000,000 for the franchise as it stood. The offer was refused. Undoubtedly Wanamaker made his offer as an object lesson to the people to show them how they were being plundered, but the fact remains that the franchise was obtained without payment of any kind to the city and that an actual offer of \$2,000,000 made for this same franchise by a responsible party was refused.

The fact that the franchise was practically stolen cuts no figure from the present point of view. It was a most reprehensible proceeding, reflecting alike upon the people and the politicians of the Quaker City. It probably led up to the later and very emphatic refusal of the people to permit somewhat similar and equally iniquitous franchises to be granted the Philadelphia Gas Combine. All this is, however, but an incident entirely apart from the question of capitalization. The franchise had an actual tangible cash value of at least \$2,000,000. The company owning it, no matter by what means it was acquired, was entitled to include this value in the corporate capitalization.

In many cases franchises are obtained by proper means, by more or less adequate payments or under agreements at least partially protective of the public interests. In other cases the public freely donate to the favored individuals these franchises for their personal advantage. The owners then, having secured their franchise, whether by gift or purchase, are by law and custom entitled to regard it and capitalize it as they would any other private property.

For instance, a little group of financiers secure without cost to them a thirty-year franchise, permitting them to use the streets of their home town for the laying of gas pipes and the distribution and sale of gas. By a simple engineering estimate they find that their plant, including the laying of pipes and all expenses up to the point of beginning business, will cost approximately \$450,000. For operating capital and as a margin of safety they allow \$50,000 more, making the necessary capitalization of the company \$500,-

ooo. They find by estimate and comparison of results secured elsewhere that after deducting all maintenance, operating and incidental expenses they can pay a fifteen per cent. annual dividend, amounting to \$75,000, on this necessary capitalization. Taking all the business risks and contingencies into consideration, they are perhaps entitled to six per cent. on their investment. A sinking fund of say \$20,000 per annum is also to be provided. After deducting the total of these two, \$25,000 is left as the annual earning power of their franchise. On a six per cent. basis, this would fix the value of their franchise at over \$400,000. In order to be on the safe side and to avoid attracting too much attention to dividends, the parties in control would probably capitalize at \$1,000,000, put in the \$500,000 in cash necessary for their installation and take out \$2 in stock for each \$1 of cash invested. On this stock they would receive an annual dividend of five and one-half per cent., or its equivalent.

Or they might, as is the more common practice, capitalize at \$500,000, this representing approximately the value of the franchise, and issue six per cent. bonds to a similar amount to cover the material values involved. These bonds would then be issued for the \$500,000 of required cash and the stock be divided among the parties in control as may have been agreed.

Or, as the full earning power of the plant would not be reached for some years, the owners might capitalize at \$500,000, issue this for cash, and then as profits

increased, increase their capitalization correspondingly, issuing this additional stock *pro rata* to their stockholders as a stock dividend until the full capitalization of \$1,000,000 was reached.

As between the parties to the investment, the capitalization, on any of these suppositions, is certainly fair and proper. They have the earning power to justify the capitalization and the fact that a large portion of this was donated by the people, or was stolen from the people, does not affect the propriety of the capitalization in the least—from a business standpoint. If a man stole a factory and transferred it to a corporation in which he was interested, the factory should show in the capitalization just the same—provided there were no flaws in the corporate title.

Neither when such stock is sold is there in the absence of misrepresentation any wrong to the purchaser. He is offered stock at a certain price, based on certain property and franchises, and paying a regular and known dividend. He must exercise the usual prerogatives of the purchaser in his investigation and if he thinks the stock is worth the money, must purchase on the strength of his own judgment.

Of course, all this does not in any way apply to the very excessive over-capitalizations that are so common—to the enterprises which are capitalized and perhaps re-capitalized and this capitalization increased to a figure far beyond any possible carrying powers of the enterprise. Even then the practice is mainly objectionable because this highly watered stock is unloaded on the public on the either expressed or under-

stood representation that the capitalization is reasonable and one on which fair dividends can be paid. Such a proceeding is a form of plundering the public even more direct than the theft of franchises, but the excessive capitalization is merely an accessory feature no more harmful in itself than is the dark lantern or "jimmy" of the professional burglar.

CHAPTER XXII.

CAPITALIZATION BASED ON PROFIT POSSIBILITIES.

The distinction between capitalization of profit probabilities and profit possibilities is expressed by the terms. Profit probabilities are usually capable of approximation. Profit possibilities are not. The grounds of expectation are too uncertain, too remote, or too unknown. Any estimate of profit possibilities is therefore of necessity much in the nature of a guess.

All the more speculative enterprises, such as many mines, new processes, inventions outside the realm of experience, and all cases where desperate financial risks are balanced against compensating profits gained in case of success, belong to this class. The real value of these enterprises cannot be ascertained short of actual development, and the possibilities furnish the only basis for capitalization.

As the actual values of such enterprises cannot be ascertained, their capitalizations are merely the expression of the hopes of the promoters, and are therefore naturally large. They cannot, however, be termed over-capitalizations in the ordinary sense of the word. If successful, the enterprise will probably sustain its capitalization. If not, the amount is a matter of small moment.

The practice of capitalizing possibilities is hardly

open to serious objection as long as the basis employed is well understood. If, however, promoters or others selling the stock of such enterprises misrepresent the conditions, directly or indirectly, for the sake of making sales, the general proceeding becomes highly objectionable. It is then nothing less than fraud, but the fraud lies in the false representations.

In speculative mining enterprises we find these "advance" capitalizations best exemplified. Here the possibilities are large and elastic, the imaginative powers of the promoters have free sway, and as a consequence startling capitalizations are common. When such an enterprise is to be offered to the public, it is first capitalized up to the limit of reasonable possibilities, as much more capitalization is thrown in as the promoters' very elastic consciences will allow, and the offering is ready. The stock is then offered at the highest figure the public can be induced to pay—which is usually a few cents on the dollar—as much stock is sold as possible, and purchasers and promoters then await the results of their "gamble." The promoters, having already taken their first profits from the sales of stock, are, however, in the better waiting position. In the majority of cases no other profits are realized.

A glance at the financial papers will furnish many illustrations of these capitalizations. The names for obvious reasons are changed, but otherwise the quotations are accurate. "Lightning Mountain" mines are advertised, "Now working in rich ore," with a capitalization of \$1,000,000 all in the treasury. Money

is needed for operating and development, and this stock is offered for a "limited period" at one cent for each \$1.00 share. That is, if the whole capitalization were sold at the offered rate, the company would have \$10,000 in its treasury. This amount, it would therefore seem reasonable to assume, is the present cash valuation placed by the owners on the property. Without any investigation, it would be very safe to say that the "properties" consist of more or less undeveloped prospects and that the valuation of \$10,000 is quite a liberal one. Just how the company can be carrying on active operations when the stock is "all in the treasury" is not explained.

In the same issue almost jostling the advertisement commented on, appears another mining proposition—"Keystone Consolidated," capitalization \$1,500,000. This is to operate a developed mine and therefore shares—"par value \$1.00"—are higher, selling at three cents each "for a short time only." Another "ad" but a few columns removed again fixes the capitalization of the "Lucky Strike" at \$1,500,000, selling at two cents for each \$1.00 share, and announces that "one big vein of \$90.00 gold ore has been reached," etc.

Another states the conditions very clearly in its advertisement. In this case stock is selling at five cents per share. The announcement explains: "The capitalization of this company is moderate—only 1,000,000 shares of the par value of \$1.00 each. At the rate of five cents a share, this means that it is like a capitalization of only \$50,000, if all the stock were

sold. Every \$25,000 net profit would mean about fifty per cent. on your investment. Every \$50,000 would mean 100 per cent. Think of that! And what is \$50,000 net profit in a prolific Nevada camp?"

A still more interesting proposition is that of a prospecting company which owns nothing at all, but thinks something can be discovered among the Nevada hills and has capitalized this possibility at \$1,000,000. This is "all full-paid and non-assessable," though how the stock has been made full-paid is not explained—perhaps it was issued in payment for the possibilities. Half this stock is offered for sale in 1,000-share blocks—shares \$1.00—at \$20 a block, or two cents a share.

In all ventures of this kind the astonishing inducements possible with millions of capitalization at command are relied upon in the appeal to the public. It is generally recognized clearly that such capitalizations are artificial and no possible measure of the value of the enterprise. Notwithstanding this, the public can not escape from the impression that capitalization does bear some relation to the real value of the property and that a share of stock of the par value of \$1.00, purchased for two cents, cannot fail to give a large profit somewhere, immediate or otherwise, and that the transaction, though not quite similar, is allied to the purchase of dollar greenbacks at ninety-eight cents off.

In justice to the mining proposition, however, it must be said that in many cases the properties represented may be worth considerably more than would be indicated by the selling price of stock. Those in

control may be and often are willing to offer their first stock at a figure very far below its real value—or its value after this first money is secured. They do this in order to get the capital needed to start things going and make the remainder of the stock, as well as that already sold, very much more valuable.

Probably in the majority of mining enterprises of this nature the capitalization bears no possible relation—save perhaps of exaggeration—to the value of the properties present or future, but is merely an arbitrary amount which the promoters think sufficiently large for their purposes. It is also to be feared that in many cases the possible profits responsible for these airy capitalizations are to be drawn from the pockets of unlucky investors rather than from the treasure houses of the earth.

In other classes of speculative enterprises large capitalizations, though better justified by the possibilities, are of necessity fixed in the same loose manner. In these enterprises, generally inventions, the value is absolutely impossible of determination and the capitalization is therefore fixed at the amount the promoters deem desirable or think the enterprise can carry. Then when the public is appealed to, the price of stock is fixed at such a figure as will make sales possible, and is thereafter adjusted and readjusted as circumstances dictate.

Wireless telegraphy affords an excellent illustration of this kind of an enterprise. No real commercial value of the wireless had been shown when the capitalization of the original Marconi Wireless Telegraph

Company was fixed at \$6,000,000. No demonstration of its practical application sufficient to justify any such capitalization had been made when a sub-company for America was formed with a capital stock of \$6,500,000, or the sub-company for Canada with a capital of \$5,000,000. The capital stock of the American company was reduced a few years ago to a moiety of its original figure. Since then it has again been increased, the new stock being sold to provide operating capital. This seems to indicate either an original over-capitalization or mismanagement, or otherwise an entire miscalculation of the conditions and requirements.

There was no uncertainty as to the value of the general results aimed at in wireless telegraphy. The basis of comparison with which it might be measured was at hand and when a reasonably complete success is reached, the proper capitalizations of the wireless companies will be easily determined. The only question was—and still is to some extent—the measure of success that could be attained.

When we come to an entirely new discovery where this “basis of comparison” does not exist, the problem is much more difficult. It then passes from the condition of a problem capable of present solution into the domain of conjecture.

Many of the important discoveries of the past twenty-five years belong to this class. The most conspicuous example is perhaps the telephone. The exploitation of liquid air is possibly one of the most characteristic.

In this latter case the product was an entirely new

one. It was surmised with much probability that its use would be varied and extended. This was, however, entirely surmise. The substance had not been produced in sufficient quantities and for a sufficient length of time to demonstrate its qualities, its applications and the possibility of its commercial use. It might be used as a refrigerating element, or it might be used as a source of power. It might be used as a "pulverizer" to make meat tender, or as a promoter of combustion to render materials ordinarily non-inflammable suitable for fuel. Many other ingenious applications were perceived and heralded and the "passing of the ice wagon" and of many other varied and even antagonistic articles and industries was plainly to be seen—according to the interesting statements of the interested parties.

All this was mere speculation, however. The article, its method of manufacture and its applications were new. There was no "basis of comparison" upon which a reasonably proper capitalization could be based. Accordingly the most prominent of the companies organized to exploit the new industry was capitalized at the modest figure of \$7,500,000. Easy dividends on this amount were figured out on the basis of different applications of the material, handsome offices were rented, interesting and striking demonstrations were given and the public was invited to invest at a price of \$5 for each \$100 share.

Whether this company was organized in good faith to develop and operate a legitimate industry cannot be said. Certainly it very shortly developed into something that looked strikingly like a stock jobbing enter-

prise run for the benefit of certain of its promoters. Every energy was devoted to the sale of stock, extravagant and unfounded claims were made as to facts and figures, and the whole thing shortly fell into disrepute and seems to have entirely disappeared.

Here the capitalization was simply a matter of arbitrary decision. In the hands of more extravagant promoters, it might have been increased a few millions—in the hands of more conservative men it might have been reduced as much. Neither could be said to approximate the correct capitalization. It was purely a matter of guessing.

Under conservative and proper management, the company referred to would probably have been capitalized at from \$100,000 to \$500,000. A substantial interest would have been assigned to the inventor, a similar liberal interest would have been allotted to the men who put in the necessary development money, a safe reserve would have been kept in the treasury and the company so constituted would have devoted its energies to the commercial application of liquid air until the value of the discovery itself and of the particular patents under which they were operating had been demonstrated to at least a reasonable degree. The value of the whole enterprise could then have been approximated and the company have been re-capitalized on the basis of this value.

As the matter was conducted it was either a stock jobbing scheme, or exhibited a very premature and improper desire to "take profits" before they were earned.

CHAPTER XXIII.

EXCESSIVE CAPITALIZATION.

Excessive capitalization may be allowable and possibly not improper for the more speculative enterprises. For the usual business corporation it is an unmitigated evil.

An excessive capitalization renders the payment of dividends difficult if not impossible. Under improper management they are paid notwithstanding the conditions, and are therefore either paid at the expense of the future of the enterprise, or even worse than this, from improper or illegal sources. In any of these cases the prestige and reputation of the enterprise are seriously damaged, its financial conduct is difficult and its final success seriously endangered. As a matter of fact, many failures of really meritorious undertakings are directly due to over-capitalization.

Also if stock in an over-capitalized enterprise is offered the public without some explanation, intimation or understanding of the true conditions, the proposition is more or less in the nature of a fraud.

Beyond all this, over-capitalization has a tendency to create and maintain an inflated and fictitious atmosphere. The enterprise is on an irresponsible basis and is too apt to be conducted on extravagant lines. Of what use are the ordinary business economies when

millions are being created by the stroke of a pen, or even less laboriously by the easy operations of a printing press? Without regard to the real value of the enterprise, a million dollar corporation is naturally more handsomely housed and equipped than is a modest company with a capitalization of but \$10,000 or \$100,000. Also its officers are more numerous, expect larger salaries and demand more generous treatment, and the same scale of lavishness obtains from top to bottom of the entire enterprise.

The whole thing is wrong and artificial and from the substantial fee of the attorney who brings the over-valued company into existence, to the residuary retainer of the attorney who attends to its decent dissolution—if enough is left to make this last sad rite worth while—the over-capitalized company is plundered and mismanaged.

Just what constitutes over-capitalization is too extended a subject for discussion here. Unquestionably any enterprise is entitled to capitalize up to its actual value as a going concern and as much further as is necessary to provide for legitimate present and future needs. It may be entitled to capitalize profit probabilities. It may be compelled to capitalize profit possibilities. Over-capitalization may then perhaps be defined as any capitalization in excess of the proper needs or necessities of the enterprise.

Over-capitalization of ordinary business enterprises usually results from one of four causes:

- (1) Fraudulent intent.
- (2) The method of promotion.

- (3) Over-sanguine estimates of value.
- (4) The avarice of owners or promoters.

Fraudulent over-capitalization borders very closely on, or perhaps includes, that vicious form of financial activity in which a capitalization is founded upon some non-existent or valueless enterprise, and where the real purpose of the undertaking is the sale of its worthless stock. In such cases the property represented by the usually generous capitalization is of little or no value, or is not owned by the promoters, or perhaps exists only in their imagination.

An exceptionally good example of this kind of capitalization is afforded by a corporation known as the "Royal Diamond Company," which some years since conducted its operations with much artistic ability and success at No. 10 Wall Street, until stopped by an unappreciative police.

This company was supposed to own newly discovered diamond fields in South America rivalling the Kimberly. Stock was being sold to secure money for the alleged development of these fields. The glittering claims and the attractive nature of the inducements were all that the subject demanded or that the imagination could desire. The undertaking was very successful in securing money.

Here not only was the foundation of the enterprise itself—that is, the diamond mines—absolutely non-existent, but so also were most of the accessories. Whole boards of directors, composed of dukes and earls and other dignitaries helpful to the business, together with banking references in different parts

of the earth, and maps, statements, diagrams, specifications, and other details necessary or desirable for the promoters' purposes, were constructed out of the whole cloth. In fact, the only real things about the unusually brazen swindle, outside the office furniture and other operating equipment, were the promoters, their dupes and the money received by the former from the latter.

The only question in such a case is whether any capitalization based solely upon the "airy fabric of a dream" can be termed an over-capitalization.

The ordinary fraudulent over-capitalization is, however, founded on something more tangible if not more valuable than the ethereal assets of the Royal Diamond Company. When properties may be secured at so little expense or perhaps at no expense at all, it does seem reckless to found an enterprise entirely on nothing, the practice having the double disadvantage of being easy of detection and difficult of explanation. Even a good man might possibly over-capitalize an existing property, but it would be difficult to convince the most confiding magistrate that the capitalization of no property at all was merely a mistaken judgment of values.

At any rate, fraudulent over-capitalizations are usually based upon actual properties located in some far away place where investigation is difficult and, as far as the smaller investors are concerned, actually impossible. In these cases the properties are deliberately over-capitalized without any regard whatever for present or future values, merely as a convenient and

impressive basis for a swindle. Many of these undertakings have been signally successful in obtaining money for their promoters. In some few cases they have landed their promoters in the penitentiary.

Enterprises over-capitalized from the second cause, *i. e.*, the method of promotion, are sometimes difficult of classification. That is, on occasion it is hard to say whether such an enterprise should be listed as a fraud or merely as an overstrained legitimate enterprise. Cases of this kind are best exemplified by the numerous and glaringly advertised propositions of the "get-rich-quick" variety, which contribute with such liberality to the support of financial advertising mediums, to the maintenance of showy offices and officers and to the payment of commissions and profits, that there is very little left for the operations of the "underlying" enterprise. As a rule, these undertakings are founded upon propositions of more or less merit. The promoters have no objection to merit if it can be secured at small expense, but this foundation enterprise is of necessity so over-capitalized to meet the numerous "preliminary" demands upon it, that there is no possible chance short of an industrial miracle that the overweighted enterprise will ever pay dividends. Frequently it does not even survive to the operative period.

Of this class mining schemes are the least, and industrial schemes the most objectionable. Occasionally a highly capitalized and widely advertised mining scheme does by some lucky strike "pay out"—the industrials of the kind rarely, if ever. After the pro-

motion period and its profits are past, they almost invariably "fold their tents like the Arabs and as silently steal away." Unfortunately this is not the only steal involved.

Over-capitalization due to the third cause—over-sanguine estimates of value—is of frequent occurrence.

Inventors are specially prone to over-capitalizations from this cause. Naturally and of necessity they are of somewhat eccentric mental action, as, unless their minds did move in new and unusual channels, they would hardly invent. This being measurably true, it is no wonder that the inventor who, after months and perhaps even years of effort, expense, experiment and disappointment, has finally perfected his design—who sees the creation of his own brain in brass and steel actually operating and doing what he intended it to do and possibly doing it well—should feel elated and be thoroughly convinced that his machine is the one above all others, and that no capitalization, no matter what its amount, will reach the actual value of his device.

The writer recalls one instance where an inventor deemed it advisable to organize a company to handle one of his inventions. At the time it consisted of a model half finished, unpatented and wholly untried. Nothing daunted by these conditions, the inventor capitalized his company at half a million dollars, one-half of which was issued to himself in part payment for the rights to his invention. In addition, the company was compelled to issue bonds to the amount of

\$50,000 in further payment for the said rights. Still further the company was required to refund all the expenditures, real and imaginary, incurred by the inventor in the course of his previous work on the invention. The company was also forced to agree to a somewhat excessive royalty to the inventor on all machines manufactured under any patents that might be obtained, and finally the inventor caused himself to be employed as general manager of the concern for a term of years at a salary in accord with his estimation of his services.

The associates of the inventor who had advanced a large sum of money with reckless disregard of the usual precautions, received stock at the rate of two shares of stock—par value \$100 each—for every \$100 of cash invested. The company is now at a standstill, pending the discovery by the inventor of more individuals of weak mentality awaiting separation from their money.

Promoters are also prone to excessive capitalization. Here the genial optimism, characteristic of and perhaps necessary to the make-up of a successful member of the profession, leads him to see "millions" in it when these values are not perceptible to the ordinary vision. Therefore, with the most cheerful indifference to the usual standards, he capitalizes on the basis of his airy belief in the possibilities of the scheme.

The most common instance of this is when an enterprise is placed in a promoter's hands for financing under an agreement that the owner is to receive a

fixed price, or a percentage of the financed enterprise, and that all the promoter can make or save beyond this belongs to him. Under such an arrangement any capitalization that the enterprise could carry and still reach its intended financial destination, would hardly be open to criticism except from the standpoint of ethics. Promoters expect to make large profits and when successful do make them. In the cases under discussion, however, it is not uncommon to find the promoters deliberately deciding upon such an extravagant increase of price or of capitalization as would indeed make the angels weep if interested in the financing of the enterprise. The load imposed is then so far beyond any reasonable profit or dividend-paying possibility, and so far beyond reason, that the whole undertaking is brought to disaster.

The experience of Mr. Charles Schwab, of Steel Trust fame, with a picture dealer of Milan, while not a case of over-capitalization but merely one of excessive over-pricing, brings out so clearly the frame of mind and procedure characteristic of promoters that it may well be mentioned. In the instance referred to, a painting by Gainsborough had been placed in the dealer's hands for sale at a fixed price to the owners, the dealer's profit lying in an advance on this basic price. The owners' price was \$3,500. The dealer, with a modest but becoming sense of the value of his own services, placed the asking price at \$25,000, and offered it to Mr. Schwab at this figure. The latter was interested and finally agreed to purchase at the figure named. This point had no sooner been

reached than the appalling conviction flashed across the dealer's mind that he had hopelessly undervalued his services. He could not raise his price to Mr. Schwab, but he could and did appeal to the owners of the picture to so reduce their price to him that he might make a living wage out of the sale. This, though ignorant of the dealer's price to Mr. Schwab, the owners refused to do and it seemed as if the unhappy tradesman must perforce be content with the meagre profit to which he had so carelessly committed himself. The negotiations had, however, leaked out in the meantime and a rival dealer of more petty ambition offered to sell the same picture to the prospective purchaser for \$10,000. This naturally roused Mr. Schwab's suspicion and he declined to have anything more to do with the matter. The first dealer then, concluding that a wagon-load of loaves was better than no bread, brought suit for specific performance of the contract, but, having either stated or given Mr. Schwab to understand that the price asked was that fixed by the owners, lost his case on the ground of misrepresentation.

In the case cited the sale, it must be admitted, was very nearly carried to a successful conclusion, and in that event the price would, from a cold business standpoint, have been justified. In the case of promoters who are utterly unable to stagger under the excessive capitalizations they impose upon themselves there is, however, no justification and the practice is difficult to explain. It is not indulged in by the better class of promoters, but it is a mistake made by many a

promoter who ought to know better. It seems to be a form of avaricious mania.

In the reading books of the old-time schools the pupils were regaled with a detailed account—interesting, if true—of the method by which the natives in some parts of Africa catch monkeys. A hole is first made in a gourd just large enough to easily admit a monkey's paw. Through this hole the contents of the gourd are removed and replaced by large and angular nuts. The prepared gourds are then securely affixed to the branches of some tree favored by the particular brand of monkeys required at the time.

The natives withdraw and the monkeys quickly flock to the scene of action to determine whether the new philanthropy is a Carnegie library or a Hearst free-lunch wagon. As soon as the real nature of the benefaction is ascertained each monkey occupying the proper respective coign of vantage obligingly inserts his paw through the hole in his gourd, seizes a handful of the nuts and tries to withdraw from the game. As the hole is of the exact size to admit the unloaded paw, this naturally cannot be done. The avaricious monkey, however, refuses to drop his prize, remains self-caught and is so held until the natives return and consign the foolish monkey, along with other captured compatriots, to an organ grinding academy.

The illustration afforded by this narrative is too good to permit us to question its veracity. It is exactly what promoters do when they load up so heavily and seek to grasp so much that they are able to do nothing. The promoter is worthy of his hire, and

its amount should be liberal, but to grasp at so much that he loses all is not only an injury to himself but a direct and unjustifiable wrong to his client.

The subject of compensation of promoters is discussed in a later chapter and will not be taken up here. For the present purpose it will suffice to say that to double the capitalization of an enterprise in order that the added half may go to the promoters is not uncommon, and is often greatly exceeded. If this were the compensation of the man who puts in the money it would be another question, but when it is merely for the parties who find the parties who put in the money, it seems excessive. More than that, the men with money ordinarily will not have it. Nothing is gained and usually all is lost.

In one case within the writer's immediate knowledge, a very practical and valuable little invention had been perfected and was ready to be placed on the market. The inventor offered it to some promoter friends for \$25,000 of the stock of the company they were to organize. Had these friends been reasonable, they would have capitalized it at a figure somewhat commensurable with the amount to be paid the inventor, and the invention would have attained the success it merited. But the promoters promptly capitalized the enterprise on the very unwarranted basis of \$100,000. \$25,000 of this was to go to the inventor; \$25,000 was to be sold for working capital; the \$50,000 of stock remaining was to come to themselves. The enterprise naturally came to grief, not from any lack of merit, but just simply because the over-capitalized offering was not attractive to men with money.

These men with money are not unwilling to be found when promoters have anything really good to offer, but they do object to having the largest part of the enterprise turned over to the promoters to pay them for the discovery. They are selfish enough to want some fair proportion for themselves.

PART V. PRESENTATION OF AN ENTERPRISE.

CHAPTER XXIV.

MANNER AND MATTER OF PRESENTATION.

In the presentation of an enterprise difficult questions arise. Theoretically, a plain, honest statement of the facts and conditions, free from color or prejudice of any kind, and coupled with a reasonable offer, ought to get the money needed for a good enterprise. Occasionally it will, but in ninety-nine cases out of a hundred it will not. Such a presentation lacks attractiveness. Capital is timid and must be reassured. The merits of the enterprise must be emphasized, the weak points fortified, the risks minimized, and the various possibilities pleasingly indicated. If this is not done capital usually betakes itself off to some other enterprise, perhaps not so good, but more attractively presented.

But this presentation, while it is expected to be favorable and will usually be enthusiastic, must be kept within proper bounds. Intentional misrepresentations or material concealments are, of course, outside the present discussion. Without any wrongful

intent, however, good points may be so emphasized as to verge on false representation, and weak points and deficiencies may be so minimized as to practically result in concealment. The line of demarcation is sometimes difficult to draw and there is occasionally a decided difference of opinion as to the exact point at which legitimate statement merges into misrepresentation.

There is, however, a wide range of open country before this "debatable land" is reached, and just how far it may be traveled with propriety must rest with the individual. He is certainly justified in emphasizing the good points of his enterprise and in setting them off to the best advantage. He is also justified in showing just why weak points are not seriously injurious and how they may be avoided or overcome. He is on safe ground just so long as his statements are honest statements; so long as his facts are real facts—stated favorably, perhaps, but fairly and not so ingeniously perverted or distorted as to lead to false conclusions.

If, however, the hopes or expectations of the owner are stated—as is not infrequently the case—in such a way as to give the impression that they are accomplished facts; if serious defects or absolute deficiencies are suppressed, avoided, or improperly explained away; if existing conditions are presented in such a way as to almost unavoidably lead the prospective investor to false conclusions, the bounds have been passed, and a moral, and sometimes a legal liability is incurred.

Also it should be borne in mind by the promoter

that any improper representations of the kind are always remembered, may come up later to the embarrassment and injury of the party responsible for them, and, finally, it should be recognized that with a fairly good deal they are unnecessary. The height of artistic presentation is to take the facts just as they are, and, without suppression, material evasion or subterfuge of any kind, state them so clearly and strongly and in such connection with the possibilities and the beliefs of the promoter—stated as possibilities and beliefs—as to carry conviction to the investing mind not only that the enterprise is a good one, but that it is in capable hands as well.

When the actual proposition is reached—that critical feature of a presentation to which everything else leads up—there is but little play for the imagination. There is no painting of the lily here. Hard, cold statements of fact are in order, so clear and so complete that there is no room for misunderstanding or for subsequent disclaimer.

This proposition is the specific statement upon which money is to be secured. In framing it, good common sense, judgment and business ability can be employed to advantage. Its details will be governed by the conditions and the necessities of the particular undertaking. If the enterprise is not strong in itself, it must make up for its deficiencies by the liberality of the proposition. If the times are hard and money scarce, the terms must again be liberal. If the owners of the enterprise are driven by their personal necessities, they must meet the capitalistic demands, and the proposition will then be generous indeed.

The method of presentation also has a direct bearing on the details of the proposition. In the earlier history of an enterprise funds for its purposes are almost always sought from one individual or from a limited number of persons. Under such conditions the parties approached easily may and usually do combine and are then apt to require that the proposition be shaped to meet their views. Not uncommonly these views involve a very disproportionate interest in the enterprise for themselves.

Just how much the owners of the enterprise must concede to this demand is, as already intimated, a matter of conditions. If the owners are financially independent, or are good enough "bluffers" to give the impression of financial independence; or if they are sufficiently resourceful to find other channels through which money may be secured, and, perhaps, work the one against the other; or if they are of sufficient persuasive power to soften the capitalistic heart, or of such ability and persistence as to be able to work the enterprise out themselves if they must, the men with money may be brought to fairly reasonable terms. If otherwise, the owners are in the hands of the Philistines and must do the best they can—which is not usually very well.

It is to be noted, however, that the possibilities of a new enterprise, and the idea of coming in on the ground floor are not lacking in attraction for the smaller investor. Then, if the men of large means are too difficult or too grasping, it is frequently possible, even in the earlier stages of an enterprise, to appeal successfully to those of less means, each one of

these putting in a small amount and their total subscriptions aggregating the larger amount needed. In such case the owner of the enterprise may arrange the details of the proposition to suit himself. The smaller investor may then accept or reject the offer, but cannot hope to modify its terms. He is not of sufficient importance to even attempt to dictate.

The first proposition in any case will usually and naturally be along the lines preferred by the owner, or be one that he thinks will secure the money. If the enterprise is a good one and the owner's proposition is reasonably fair, he may be able to carry it through. It is, however, rarely that an enterprise is financed on an inflexible proposition. Changes desired by the investors may be unobjectionable or perhaps entirely proper, and in either event will naturally be conceded. In perhaps the majority of cases they are at least partly reasonable, and concessions must then be made on both sides.

At times when the conditions are difficult or perhaps not fully known, the simplest way of arriving at a proposition that will secure money is by the experimental method. The owners arrange a tentative offer that seems fair to them, with possibly a trading margin added. They then try this on a "dog"—or otherwise a capitalist. The justness of the proposition is judged by the results. The capitalist is apt to express himself freely, and, with due allowance for peculiarities of the particular capitalist, a very fair idea of the merits of the trial proposition may thus be obtained and the proposition may then be modified in the light of this knowledge.

All the more important features which affect it should appear in the proposition, though in what detail will depend upon the particular conditions. If the owners of the enterprise are to give their time to its operation, a demand for reasonable salaries or stock compensation is but fair and would properly appear in the proposition. The amount of these salaries might, however, be left for later settlement. Or if minority interests are to exist the proposition might require reasonable protection for them, the method by which it is to be attained being left for future agreement. If a specified management is to control, proper stipulations should be made in the proposition and might very well provide the method for its maintenance. If royalties are to be paid, they should be so secured by provisions for minimum output and specific dates of payment as to really protect the owner, and stipulations for such protection would usually appear in the proposition.

When options on properties or the properties themselves form the basis of an enterprise, peculiar conditions are frequently introduced into the proposition. These arise from the fact that the properties or options are usually owned or controlled by the active parties or "promoters" who are financing the undertaking and who organize corporations for the express purpose of taking over or purchasing these properties.

If the properties are turned in to the corporation at the actual purchase or option price to the promoters, the transaction is legitimate and unobjectionable. Usually, however, the promoters turn these properties in to the corporation at prices higher than those called

for by their options, or if the properties are owned by them, at prices higher than their own purchase price, the difference representing a profit to the promoters. Even here there is nothing to be said if the facts as to the promoters' profits are known to all the parties concerned. When, however, the promoters, in order to avoid criticism and objection, attempt to conceal the fact of their profits, the procedure becomes an infraction of the law and is liable to be overturned at the suit of any party immediately interested.

These conditions, which frequently arise, are not generally understood and the complications that may ensue are so serious that the following somewhat lengthy quotations from "Conyngton on Corporate Organization" (page 272 et seq.) can hardly be deemed out of place.

"For the purposes of the present consideration the promoter is one who concerns himself in the financing and organization of a corporation with a view of realizing special profits. In a large proportion, if not the majority of such cases, the promoter has brought about the organization of the corporation for the express purpose of securing these special profits. There is no intrinsic iniquity or injustice in so doing. The only question is as to the propriety and legality of his arrangements for their collection. * * *

"The relation of the promoter both to the corporation and to those associated with him in its organization is one of trust. He is guiding the affairs of the incipient corporation and is supposed to be safeguarding its interests as he would his own. * * *

"This doctrine is too clearly established to be questioned. The confidential relations of the promoter being admitted, it follows then that while he may with entire propriety and legality profit by his connection with the corporation, such profit must be made and taken in such ways as are compatible with these existing confidential relations. * * *

"The usual mistake of the promoter is in dealing with the corporation as he would with a stranger. Unreasonable or even large profits are difficult of attainment if the party from whom they are to be drawn is informed as to the facts, and for this reason the promoter wishing to sell property to the corporation usually conceals, or worse still, misrepresents its real cost. If the property were actually owned by the promoter and had been so owned before the organization of the corporation was undertaken, the status would be different. Then, under proper conditions, there would be no compulsion upon him to reveal the cost of the property and he might sell it to the corporation at any agreed price, and, in the absence of misrepresentation, without fear of legal consequences.

"Usually, however, the promoter does not own the property taken over by the corporation, but either holds it under option or is acting in the interests of the real owner, who pays him a percentage of the price secured, or allows him to offer it to the corporation at an advanced price, protecting the promoter in all excess over the real price to the owner. When the promoter occupies this position, unless with the full knowledge of his associates and the corporation, he is in conflict with the law, for it has been laid down

clearly and unmistakably that a promoter must not make any secret profit out of his corporation, or out of those associated with himself in the formation of the corporation. * * *

"From the cases cited and the additional cases given hereafter, it is clear that any special profits made by the promoter are illegal unless made with the full knowledge of all the others interested or with the consent of an independent and fully informed board of directors, or with disclosure of the conditions to intending stockholders. Suit for redress might be brought at any subsequent time by the corporation, or, under some circumstances, by the stockholders who have immediately contributed to the promoter's improper profits by the purchase of stock on its first issue, or of treasury stock thereafter. * * *

"The laws are very clear in their denunciation of the promoter's secret profits. They are hardly less explicit in their recognition of the promoter's right to profits if secured and taken under proper conditions. In I Morawetz on Private Corporations, § 293, it is said:

"'However, there is no rule of law prohibiting a person from forming a corporation for the purpose of selling property to it and making a profit from the sale. The law merely requires that such a transaction be entirely open and free from deception upon the company and upon those who become members.'"

From these quotations it seems very clear that the promoter is well within his rights when he organizes a corporation to purchase his own property, provided that such purchase by the corporation is directed by

an independent board capable of impartial judgment as to the value of the property and the advisability of the purchase by the corporation, and is made with full knowledge of the fact that the property in question belongs to the promoter. In such cases the promoter having purchased or otherwise acquired such property before the inception of the corporation, was not and could not then in any way have been acting as the agent or trustee of the corporation. He may have acquired such property at any price or in any way, and, when later the corporation is organized, he is at liberty to offer this property to the corporation at any advanced or different price he may choose, without divulging the profits to be made thereby. The one essential is that such offering shall be absolutely without misrepresentation. If he represents that the property is owned by him when only held by option, or that it is turned in to the corporation at the cost to him when he is really making a profit, such misrepresentations are, under the circumstances, material and render the promoter liable for the secret profits so secured. Without such misrepresentation, however, he may make what profit he will.

When secret profits are to be made several different methods are employed to effect the necessary transfers without revealing the promoter's profits. These are sometimes allowable, but are in most cases of doubtful propriety and perhaps of doubtful legality as well.

When the owner of the properties is willing to assist in the concealment of profits, he will sometimes give options to the promoters at the advanced figure fixed by them, agreeing at the same time to "protect"

the promoters—that is, to pay over to them all amounts received by him in excess of his private asking price. This is the simplest method of arranging the matter. Then as soon as the owner receives his money he turns the excess price over to the promoters and the transaction is closed.

Another plan is for the owner to give two options to the parties, one at the real price, the other at the advanced price at which the property is to go into the enterprise. The higher priced option is exhibited and apparently acted upon. When the properties are to be transferred, the deeds or assignments are escrowed with some trust company or other reliable trustee, under an agreement that upon receipt of the advanced or fictitious price, the deeds or assignments are to be turned over to the parties making the payment, the owner is to be paid his real price, and the option parties are to be paid the balance which represents their profits in the transaction. This is obviously merely a variation of the preceding plan, but is frequently preferred.

If the owner of the property is not willing to become a party to the concealment, a plan sometimes pursued is to take the option out in the name of a “dummy”—that is, some friend or associate of the promoters, who appears in the matter for some nominal payment or perhaps purely for accommodation. This dummy, after the option is made out to him, gives in turn an option to the promoters at a higher price, and this latter option is the one that is shown. The actual transfer of the property is then again handled through a trustee, who makes the delivery and necessary payments.

This is obviously a more risky proceeding than the former, as here the owner is not an accomplice, usually has no reason for concealing his price, and the details of the transaction are therefore almost certain to become known. In such case, trouble is likely to ensue for the promoter.

CHAPTER XXV.

PREPARATION FOR PRESENTATION.

The majority of enterprises to be financed are very inadequately prepared for presentation. This may be due either to ignorance of what is required or to an unwillingness to go to the expense or trouble involved. Be this as it may, time after time enterprises are presented in such a crude, unfit condition, with so little perception of what ought to be provided, or what may properly be required, as almost to invite their failure.

An out-of-town inventor will put a bundle of drawings in his pocket, or a model in his grip, and come on with the triumphant assurance that he has every requisite for a successful presentation. The idea that patent papers will surely be called for, or that he will be asked for a clear statement of what his mechanism will do, and why his method is better than others, or that an exposition of the general state of the business will be required, or that half a dozen other things will be demanded, never seems to occur to him.

Or the Western man with a mine will break out some good big samples of attractive ore and board a train for the East with a perfect conviction that he has everything for his presentation that the most exacting could require. When he is asked for maps, title papers, assays, expert reports and the other neces-

sary features of a proper presentation, he is totally unprepared. His omissions may be rectified, but this involves delay, and when he is ready the interested parties have probably cooled off and the unready miner must prospect further for the capital he needs.

It must be borne in mind that the financing of an enterprise is a very particular matter. Interested parties may be discovered almost at the first attempt; more often only after considerable search; sometimes not at all; but whenever they are found, the materials for the presentation should be at hand so that it may be made while the opportunity offers.

Before a presentation, then, the enterprise itself should be put in the best possible condition and everything should be provided that may with propriety be required by parties investigating the proposition, or that is necessary to give a proper and favorable knowledge of the undertaking, or that will be required in conducting the negotiations. Some of this preparation and material may not be necessary. The probabilities are that most of it will, and when anything of the kind is needed, like the Texan's pistol, it is needed badly—in fact, it must be had. Many a promising trade has been broken off and lost absolutely just from lack of this proper preparation.

As a first step towards the presentation of an enterprise to be financed, the invention, the business, the mine, or the other property or undertaking upon which it is based, must be gotten into the best possible business shape, both as to physical features and as to the general conditions with which it is surrounded.

The importance of this is obvious. The most de-

sired and most desirable condition of any enterprise is that of a "going concern." If the enterprise is a going concern it will naturally be regarded with greater favor and secure finance on better terms if in the best possible operative condition. If it is not a going concern the nearer this state is approximated, the stronger the presentation that can be made, the greater its attractiveness to the conservative investor and the better the terms upon which the necessary finance may be obtained.

For example, suppose an ingenious inventor has devised a new and, to all appearances, a much improved typewriter of a standard pattern and wishes to get the necessary funds to develop, patent and push his invention. At the time of consideration it exists merely as a design in a more or less complete condition.

At this stage a long and tedious road lies between the invention and final commercial success. Patents are to be secured in the face of the multitude of typewriter patents already granted and this is likely to be difficult. The device may prove to have been already patented, or to be not patentable, or there may be important interferences and long, vexatious delays and costly legal work, and possibly unjust and damaging decisions to be fought, or to be acquiesced in as business policy may dictate. If the patents are finally granted, the claims may be so attenuated or so materially modified as to be of but little value, or to permit of easy evasion.

Also, after the patents are secured, or if the owners of the enterprise are sufficiently confident, while the

applications are pending, models must be constructed in order to demonstrate the workings of the mechanism. Or possibly a caveat will be filed, or perhaps merely a preliminary search of the patent records will be made to determine as far as may be the patentability of the device, and if the results of this search are satisfactory, models will be constructed before either a caveat or patent applications are filed. This is a somewhat risky proceeding, as a patent is never secure until it is actually granted, but it has the advantage of allowing the original patent applications to cover the mechanism with all its features as finally decided upon, instead of merely covering the first rude designs that are almost invariably greatly modified by the experimental work of model-making.

Be this as it may, if a model is attempted the work will be heavily expensive. No matter how experienced or how practical the inventor, the model work is almost certain to show numerous defects in the original designs, and suggest many improvements to be introduced before a practical working mechanism is obtained. Not infrequently the demonstration of the model calls for a total recasting of the original device, or for what is practically a new invention, retaining not one single important feature of the original design. Occasionally the nature of the invention itself is changed, as in a recent somewhat remarkable case where the inventor, having secured the financial backing of friends, started in to develop designs for a smoke consumer of a supposedly very superior pattern. After the expenditure of much time, thought and money, the smoke consumer, by a not entirely

unnatural process of evolution, became an improved furnace feed. Thence, however, by a very singular metamorphosis that has not yet been satisfactorily explained, the erstwhile smoke consumer emerged triumphantly from the debris of inventions and experiments as a very effective gas stove. This was patented, manufactured and put on the market with much success and to the very considerable financial advantage of those immediately concerned.

In the case of our supposed typewriter, however, even after the invention is patented and worked out to a more or less successful conclusion—which is usually a matter of many thousands of dollars—a further and much larger investment is then necessary in order to provide the tools and machinery for its manufacture. One hundred thousand dollars would be a very modest estimate of the total cost of development and of equipment of factory. After all this has been accomplished there still lies before the enterprise the very difficult problem of working up a prosperous business in the face of strong and able competition.

All this confronts the inventor in the first inception of the enterprise and, if the men with money are at all experienced in matters of the kind, is known to them. It is true that in other lines the difficulties to be overcome might not be so great as in the somewhat crowded and very troublous field of typewriter invention, but in any case where an inventor and an untried invention are concerned, the obstacles, risks and probable expenditures are great.

At this early stage the inventor may secure the money he needs—it is frequently done—but it is usu-

ally a matter of difficulty and great inducements. It is then largely a speculative offering and must be financed as such.

If, however, before endeavoring to finance his invention, the inventor carries it a step further, and secures his patents, the situation is very much improved. Before, patents might have been refused, or be granted but in part, and the investment be more or less of a loss. Now this very serious danger is removed, the actual expenditures involved in securing the patents have been made, and, while there are still many troubles before the enterprise, substantial progress has been made, its general condition is better and it is therefore more attractive to the investor. Money would then be much easier to secure and the interest that must be offered for this money would be less than before.

If the patents had not only been secured, but in addition a successful working model could be shown, the conditions of the enterprise would be immeasurably better. Then, granting that the new device had merit, there would be only the ordinary business risk before the enterprise, and the inventor would receive ready and even eager attention from practical men who at an earlier stage could not have been interested on any terms.

It is to be noted and remembered that unless the inventor and his immediate associates have sufficient financial strength to carry the matter through to the position of a successful business enterprise, this is about as far as it is expedient for them to go. The inventor is still well within the limits of his own province and, with a patented invention and a success-

ful model, he is at least theoretically in a position to meet the investor with composure. His patents are running against him, it is true, but with seventeen years in store, a moderate delay is not serious and if the investor wishes to hold over and negotiate, the inventor can do likewise, or can employ his time in looking up another more active investor. It is then that he comes nearest to realizing the abstractly correct position that the enterprise is as important as the money. In practice, he will probably finance his invention at this time on advantageous terms that before would have been absolutely impossible.

Should the inventor, however, decide to go ahead with the actual commercial development of the enterprise and begin the construction of tools and machinery, he is leaving the field of invention and invading the domain of business. He must then be very sure that he has the ability and means to carry the enterprise through to financial success. Should he fail to do so and have to ask for money midway, a worse position for the new enterprise could hardly be imagined. It must have more money to save that already invested. Meanwhile it cannot stand still. It must either go forward or backward. Rent is running, bills for labor and material must be paid, general expenses are mounting up with startling rapidity, and meanwhile the inventor is busy looking for funds.

Under these conditions the enterprise is looked upon as already a failure and most men of means will have nothing to do with it. It has apparently fallen before its wings were fairly spread for flight. It is the natural victim for the vultures of the financial world. As

a matter of fact, it is unfair to style the financier who comes to the relief of such a crippled enterprise a "vulture," even though his terms may be severe. The parties to be reproached are those who have brought the enterprise into its unfortunate and embarrassing position, and the man with money who comes to its relief and starts it once more on the way to success is entitled to a most generous reward.

If the inventor and his friends are able to carry the enterprise through to commercial success—as is not infrequently the case in matters involving less expenditure than the manufacture and introduction of a new typewriter—it is, of course, advantageous and very advisable that they should do so, but unless they are very certain of their ability to do this the risks are too great to justify the attempt.

Just where the point for advantageous financing is found will vary with the nature of the enterprise, but speaking generally, the further it is carried the better for the inventor, provided only that he stops short of any position from which he can neither advance nor retreat, nor even stand still, but must have quick money to save the enterprise from loss and possible disaster. He should have as few loose ends out as possible, should keep everything clean as far as he goes, and should go as far as he can carry the enterprise successfully.

Whatever the stage that may have been reached before the enterprise is presented for financing, it is a matter of much importance that the material conditions of the invention, mine or other property upon which the enterprise is based should be of the best.

If the subject matter of the enterprise be an invention, the designs should be well drawn on suitable paper and be clean and workmanlike. If a model has been constructed, it should be as neat, well made and business-like as possible. Inventors are too apt to underestimate the importance of such matters and take it for granted that the mere demonstration of the principles involved is sufficient, and that anything that will do this is all that is necessary. They make a sad mistake when they do. A rickety model, tied with strings and loose at the joints, may demonstrate the principle beyond question. If, however, the model breaks down once or twice in doing so, or a joint comes uncoupled, or a string untied, and the exhibition has to wait until repairs are made, the demonstration is very far from satisfactory—so much so that the man with money frequently concludes that the principle has not been demonstrated at all, or decides in his own mind that if the machine does not work well now, there is doubt as to its ever doing so. Moreover, in the minds of those looking into an invention, the character of the model has much weight as an indication of the kind of man they are dealing with.

At times financial considerations will compel a home-made model. If so, it should be as well made as the conditions will permit. If string must be used, it should be good string and well tied. If the model must be whittled out of wood, it should be neatly done and be as secure and practicable as possible. Its "lame" operation does not, of course, really affect the principle, but it does affect the "principal"—the man to whom the exhibition is being made. For this reason,

if it can be afforded, polished brass and shining steel, solidly mounted and forming a well-constructed and smoothly-working mechanism, are justifiable and profitable. The matter must not be overdone, but carried to the proper point, it indicates strength and ability on the part of the inventor and places him in a favorable position for negotiations.

In the case of a mine, a quarry, a factory, a mill or other similar property, where power, massiveness, output or capacity are the essential features, the same regard to superficial appearance is neither necessary nor desirable. Effectiveness and system are the great desiderata in properties of this kind. A certain amount of roughness, massiveness, debris, grease and dirt are practically inseparable from the recognized conditions of production, and if not found, might lead to unfavorable deductions. The property must not convey the impression of having been "slicked up" for the occasion—at least to an unreasonable degree. It is expected that it will be put in the best possible condition of effectiveness, but anything beyond this is not desirable.

For example, if additional funds are to be secured for a producing coal mine, a general cleaning and overhauling will probably be undertaken to prepare it for inspection. This is entirely proper and is expected. Engines, shafts, hoists, drifts, ventilators, cars, tipples and the various other paraphernalia of the business should be placed in first-class working condition. If this is not done the effect produced upon those inspecting the mine would usually be distinctly unfavorable.

If, however, instead of stopping here, the powers

in control went further and, for instance, painted all the woodwork a bright, unsullied white, reduced the culm heaps to pleasing geometrical proportions, attired the men in fresh white duck suits, and presented the breaker boys with clean hands and shining faces, the effect would be anything but happy.

Of course the overhauling of such a property would never be carried to this ridiculous extreme, but it is a fact that it may be and very frequently is carried too far. Usually the proper point is the point of greatest effectiveness, but the conditions that will best evidence this, or be most effective in financing the property, will vary with the circumstances and with the character of the men who are to make the inspection. At times the inspectors of a mine such as that considered will even prefer a slovenly appearance under the delusion that it indicates concentration on the main features of the industry, and shows that no time and attention are wasted on elegancies that might be devoted to the getting out of coal. On the other hand, the inspectors may be particular to the point of finickiness, and, if this is known in advance, the property should be prepared accordingly. Where the taste of the inspectors is not known, the safest plan is to put the property into first-class operative condition and go no further. If this is done, the impression produced—if the inspectors are business men—cannot be very unfavorable or such as to stand in the way of business.

Just how far the preparation of a property for inspection may be properly carried, when such preparation may possibly mislead, conceal or give a distinctly

false impression, is, at times, a difficult question. The salting of a gold mine, or the "colonizing" of tenants in an office building, is merely preparation carried to an improper extreme. Certainly any preparation that gives an absolutely false impression of the property or its possibilities is "beyond the pale." The fairest preparation would be such as would be made preparatory to a formal inspection of the property by an owner, a superintendent, or someone else familiar with its general features upon whom no false impressions would be attempted or be possible. Everything would be put in the best possible condition, but there would be no concealment, no attempt at imposition; defects would neither be suppressed nor exaggerated; the property would be exhibited at its best, but not as being better than its best.

It is not, of course, to be expected that the parties interested in a property will specially emphasize its defects. On the contrary, it is expected that they will minimize them, and that the strong points will be emphasized. It is not expected, however, that they will deliberately attempt to suppress or conceal any materially weak points, and should they do so, it might later afford ground for very troublesome legal proceedings.

Sometimes this whole point is avoided, the parties owning or controlling the properties simply declining to make any representations or guarantees in regard to them, stating that the properties are there subject to inspection and for sale at the stated price; that the parties looking into them can conduct the inspection as they see fit and draw their own conclusions. This

“caveat emptor” position is not improper, but is suspicious, and would in many cases be held sufficient ground for a termination of the negotiations. The parties investigating properties under any such conditions must look for and expect to find defects and bad points that do not appear on the surface.

Even in case of a total disclaimer the party owning the property does not relieve himself of responsibility if it can be shown that he was in possession of material facts which could not be discovered save by accident or by an unusual investigation. Suppose, for example, that a new shaft sunk on the main vein of a mine shows that this vein pinches out, and that thereupon the owners quietly withdraw from the shaft and let it cave in or assist it in so doing, continuing their active work in the old shafts, which are apparently in a good heavy vein. They then offer the mine for sale, make no specific representations as to the property and leave the inspectors to discover the conditions if they can. Under these circumstances the owners—although they made no representations—are liable to any purchaser who buys on the supposition that the vein continues, just as they would be if they made a direct statement to this effect. They sold the property at its face value, but this apparent value was false, and if the owners can be shown to have knowledge of this fact, they may be held to account.

CHAPTER XXVI.

THE PROSPECTUS AND OTHER PAPERS.

The presentation of enterprises falls roughly under two heads—public and private. The public presentation is usually made by means of advertising, followed up by printed matter of various kinds. Its object is to reach a large number of people, and publicity is sought. The private presentation may perhaps reach a number of people, but it is more or less of a “still hunt,” general publicity being avoided or looked upon with indifference. It is usually a personal presentation with printed or typewritten matter to reinforce or assist the personal appeal. The great majority of presentations are private, and for this reason the private presentation is given the greater prominence in the considerations of the present and succeeding chapters.

The prospectus is usually the leading documentary feature of a presentation, around which the others revolve. A good prospectus is an invaluable aid in financing an enterprise. A poor prospectus is perhaps worse than none. A strong presentation with a weak prospectus is practically an impossibility. On the other hand, a strong and artistic prospectus is a better covering than even the mantle of charity for any minor sins of presentation.

It may be noted that the use of the prospectus in private presentations is by no means invariable. Enterprises are sometimes financed without it, the verbal statements of the parties, coupled perhaps with a demonstration of the more material features of the undertaking, producing the desired financial results.

The writer recalls an instance of this kind in which a very successful financing was conducted entirely on the "still hunt" basis, no prospectus being used and no papers employed save typewritten statements exhibited and kept in the office of the incipient company. In this case an expensive suite of offices was leased and handsomely furnished. A full corps of officials and selling agents were in attendance. These latter were men possessing considerable social gifts and some acquaintance which enabled them to reach men of position and means.

No advertising of any kind was indulged in, but when the scheme was in operation one of these salesmen would quietly "tip" an acquaintance that something good was being passed around and that he had better be on hand. Such an intimation rarely failed to excite interest, whereupon the victim was invited to accompany the salesman to the company offices. Here everything was on a due scale of subdued but substantial elegance. The enterprise had for its end the production of a certain material. Handsome samples of this material were exhibited in various forms and numerous applications; mysterious hints were given of the great profits—mostly imaginary—being reaped elsewhere; weighty names of interested parties were exhibited; plausible statements were freely made,

and the general impression was created and well sustained that the opportunity of a lifetime was within reach and could by quick action be grasped and held.

The whole presentation was artistic, not to say aristocratic, and was eminently successful. All the money asked for was secured, and the enterprise was duly launched. Its subsequent career was not as productive of results as was its financing, and the money invested in the enterprise was practically lost—except as to the returns reaped by the promoters.

Generally, however, the prospectus and its accompanying papers are desirable. In many cases they are essential. They may perhaps be used merely to introduce the matter, or to reinforce and substantiate a verbal statement, or to follow up a personal presentation; or they may do the entire work. At some stage of the presentation they are reasonably certain to be required.

It goes almost without saying that the prospectus should be neat and well arranged from a mechanical standpoint. It is true that the main and only end of the prospectus—as of the other presentation details—is to excite interest and draw money into the enterprise, and that everything else—literary elegance, arrangement, appearance, style and even grammar and expression—are subservient to this one end. That is, without regard to anything else, that prospectus is best—within the limits of legitimate statement—that produces results, and all else must give way to this one object. It will generally be found, however, that the neatest and best arranged prospectus, both as to matter and mechanical make-up, is the one that does

produce the best results. A slovenly, sketchy, ill-arranged prospectus, such as is too often presented, with important facts omitted or badly stated and unimportant facts emphasized, weak in appearance and even weaker in matter, is an abomination quite sufficient in itself to condemn the most meritorious enterprise.

If the parties presenting the enterprise are unable to prepare a suitable prospectus, they should by all means secure competent assistance. There are in all the larger cities men who make a business of preparing prospectuses and other commercial literature. They are usually good in their line and reasonable in their charges, and where any doubt exists as to the suitability of a prospectus, or as to what should be included in it, or as to its arrangement, style, etc., their assistance should be invoked.

The cost of such work varies greatly with the character and length of the prospectus, the standing and reputation of the writer, and the matter to be included. A good short prospectus of three or four pages would hardly be secured from one of these professional writers for less than \$25; from this price it will range up to \$50 or \$100, as the length or difficulty of the prospectus increases. If the enterprise is important and the amount of work is large, the price may be much more.

In most cases it is possible to tell about how long any particular prospectus should be, and to fix the price for its preparation before the work is undertaken. Wherever possible this should be done. Otherwise, with perfect good faith and proper charges on the part of the writer, the cost of the prospectus may, at

times, prove unexpectedly high—even to the point of embarrassment if funds are limited.

Sometimes, however, it is impossible to tell in advance just what the length and difficulty of a prospectus will be, and then the matter must either be left to the honor of the writer—which is usually safe within limits—or a lump sum be agreed upon, or a price be fixed which is not to be exceeded.

If in the hands of a competent man, the prospectus so prepared will be clean and attractive in appearance, interesting and effective as to manner and material, and written with a special view to the party or parties to be approached. In addition to the actual writing of the prospectus, the men who do this work will usually suggest the other documents and materials necessary for an effective presentation, and give such other information and advice in the premises as may be necessary. This incidental help is frequently worth more than the price paid for the prospectus. When the prospectus is not to be printed, these writers will usually include in their price the making of a reasonable number of copies so that no additional expense need be incurred in this direction.

If the prospectus is to be printed, the professional writer will, if desired, take charge of the whole matter, or in any case will suggest the style, the design, the paper to be used and the best material for cover, and will also correct proof and generally supervise and look after the matter until the prospectus is complete.

It may be said here that in a private presentation, it is rarely necessary or even advisable to print the prospectus. To do so would, generally speaking, be

somewhat ostentatious and take away entirely that air of freshness—that pleasing suggestiveness of a “ground floor” basis—that should characterize and add to the attractiveness of the budding enterprise. For the same reason it is rarely advisable to reproduce the prospectus by mimeograph or other copying device. The ordinary business man is seldom deceived by any such device, and when a prospectus so duplicated is received, it at once suggests to him that the offering is being made generally, or, as it is styled in promoting circles, is being “hawked”—a proceeding that at once relegates the enterprise to the lowest social circles of financedom.

It is true that in some large matters of private presentation, and particularly where the presentation is being made by men of means, the prospectus is printed to advantage. Here it is known that the importance of the matter and the financial ability of the men behind it justify this usually unnecessary expense. It does not then convey any impression of extravagance or of “hawking.” It is also true that occasionally in the smaller enterprise the printed prospectus may be used with good effect. Usually, however, such conditions do not obtain, and the prospectus should then be merely typewritten in a thoroughly neat but unostentatious style. Side or centre headings for subjects, wide spacing between paragraphs, good margins, and any other devices that tend to make the prospectus attractive and its presentation clearer or more easily grasped are good. Red ink, capitalizing and underscoring are helpful if not carried to excess, but otherwise are worse than useless.

It may be said in passing that paper of legal cap size is usually preferred for prospectus purposes when the document is to be typewritten. This may have the red marginal ruling, found in much of the paper used for legal documents, if desired, though the plain paper is perhaps more generally used. Plain paper of letter size is not infrequently employed for the purpose, but a smaller sheet is hardly allowable—that is, such paper would ordinarily produce an unfavorable effect. Whatever the kind of paper used, it should be of good quality. A thin paper may be desirable at times, but its quality should be at least fair, and would better be first-class. Where carbon copies are taken, it will be obvious that they should not be given to important men. Such copies are entirely adequate for “office copies,” and may, perhaps, be utilized for smaller or unimportant men, but to parties whose money, influence or co-operation is specially desired, first copies only should be given.

The general style of the prospectus will vary with the manner in which it is employed. It may be used as the principal or perhaps the only means of arousing interest in an enterprise, it may serve as a forerunner of a personal interview, or it may merely follow and reinforce a personal presentation. In the first two cases the prospectus must be prepared on the basis of attractiveness. It should be tasteful and even striking in appearance, and interesting as to its subject matter. It must be arranged so that not only he who runs may read, but so that the runner—or otherwise the busy man—will want to read and avail himself of the opportunity then and there.

If, however, the prospectus is merely employed to follow up a personal presentation, the parties to whom it is presented are supposedly already attracted and interested, and the aim of the prospectus is then to give the most convincing and clearest possible statement of the whole matter, or of its more important points. In such case striking originality as to make-up and expression is not only unnecessary, but at times even irritating, making the essential facts more difficult to unearth, and the prospectus should then be as plain, clear and direct as it can be made. There is no longer the necessity for making the prospectus striking and attractive in itself which existed in the first-mentioned cases.

The beginning of the prospectus is important. Formerly almost invariably the prospectus of an incorporated enterprise was headed with the organization data of the company, including the names of its officers and directors. At the present time the tendency is to relegate this very desirable information to a less conspicuous position, on the ground that it is of no importance to the reader until after he has become interested in the enterprise, and that the prospectus is better begun with some attractive matter of real interest that will seize and hold his attention from the start.

This general idea is excellent. It must, however, be remembered that the "guinea pig" industry is not entirely a thing of the past, and that when a name is purchased with a great price it will hardly be hidden in small type and a remote corner of the prospectus. Also, not infrequently and with entire propriety, the names of those connected with an enterprise constitute

the strongest feature of its presentation—the feature of most importance to those to be interested. In any such case the names cannot be given too great prominence, and they will naturally appear at the head of the prospectus. Also when the prospectus is to be employed with parties who are already interested, a prominent position for the names is usually desirable.

As a rule, however, and particularly in public prospectuses, the general principle that the document should be opened by matter of more material interest than organization data and official names, is entirely correct. In the case of a printed prospectus, the whole difficulty is sometimes ingeniously evaded by printing the name of the company, capitalization, names of officers and directors, etc., on the inner cover page. There its position is almost as conspicuous as if placed at the head of the prospectus proper. It does not, however, interfere in any way with the strongest opening matter that can be devised. If the reader is interested in these names and other organization data, they are at hand. If not, they do not distract his attention and he can plunge at once into the subject matter of the presentation.

As to this subject matter of the prospectus, it should be clear, direct and logically connected. As far as possible the material should be interesting, but the main end to be attained is a strong presentation of the material facts of the undertaking, and irrelevant matter should not be brought in merely for the sake of interest. All the important points of the enterprise must be included—unless some are purposely omitted or reserved for more effective presentation in other

ways. A clear view of the purposes, the scope and the particular advantages of the special enterprise must be given, and to do this the prospectus must touch with more or less fullness on all the important details. This should, of course, be done in an artistic manner, so that the reader will not only get a clear understanding of the why and wherefore, but get it from such a favorable standpoint and in so "attracting" a manner that he will be interested both in the enterprise and in its promoters, if possible, to the point of joining them. All through the prospectus this one vital point must be kept in mind—that its sole end and aim is to interest the reader in the enterprise and get him to invest his money.

In a later chapter, entitled "The Investor's Questions," is given a list of the vital points of an enterprise considered from the standpoint of the investor. These, as will be observed, cover the field quite broadly, and include in a general way all the important details that should be introduced into the prospectus and be brought out by the general presentation. It is a matter to be decided, of course, in each particular instance, just how much of this information the investigating parties are properly entitled to, how far into detail it is advisable to go, and what should be brought into the prospectus and what left for more private discussion. Speaking generally, most of the information called for—as far as the queries apply—and possibly even more, is pertinent and legitimately to be demanded by an intending investor.

It will be understood that a public presentation is contemplated by "The Investor's Questions," while

a private presentation is more particularly considered here. This private effort may be merely preliminary to a public presentation, or it may be the final presentation, sufficient money for the full development and operation of the enterprise being obtained without public appeal. In either case the conditions are different from those of the public appeal and call for even fuller information. The parties now entering the enterprise come in on a much broader basis than does the general investor, perhaps supplying capital largely, possibly participating, or even taking over the management, and in any event joining the enterprise more as associates of those already concerned than as mere investors in its stock. They are usually supposed "to come in on the ground floor"—though this supposition is frequently somewhat at variance with the facts—and to assist in the upbuilding of the undertaking, and they are entitled to know and will usually demand every important detail of the enterprise.

In any event, every vital point of the enterprise should be included in the prospectus—unless presented in some other way—as otherwise not only is necessary information lacking, but it is a reasonable supposition that it has been suppressed intentionally. On the other hand the presentation should not be too full. Detail, if carried too far, is obscuring. Also some points may with propriety be omitted from the prospectus as not being vital, and as tending to give a wrong impression of the undertaking.

As to the points that may be omitted from the prospectus, judgment is required. So much of the facts should always be given as is necessary to a fair esti-

mation of the real value of the enterprise, but, beyond this, prejudicial details are properly omitted. The public has been trained by long and costly experience to expect that the favorable points of an enterprise will be emphasized to the utmost and that unfavorable points will either be omitted entirely or be touched upon as lightly as the law and the conscience of the presenter will permit. If, then, a contrary policy is pursued, a distinctly false impression is likely to be given by the very effort to be fair.

To state the matter briefly, the owners of an enterprise are not justified in misrepresentation or material suppression, but they are entitled to such a presentation as will exhibit the enterprise in a favorable light—the light in which it appears to its friends. They can therefore fairly omit non-essential details that would interfere with such a presentation.

As to the termination of the prospectus, it may be said that here, as in any other case of salesmanship, the strongest appeal and most convincing arguments should be brought to bear. In other words, the sale must be clinched while the purchaser is still under the spell.

This is one of the most difficult features of the presentation, and particularly of the public presentation, in which the influence of the salesman must be exerted at long range and through the medium of cold type. To excite an interest is not hard. With a good proposition well presented this interest may, without much difficulty, be worked up to the point of a desire to purchase. To change this desire into an active and reasonably fixed determination is very difficult.

It usually requires not only a strong, effective and well closed presentation, but facilities for prompt execution of the reader's resolve. Otherwise the whole impression may be dissipated and lost. To this end, if the presentation is private, the party presenting the prospectus will probably close the matter in person. If the presentation is public, order blanks, return envelopes and full instructions for remittance will probably be enclosed with the prospectus. Nothing should be omitted in any case that will make actual subscription easier.

CHAPTER XXVII.

THE PROSPECTUS AND OTHER PAPERS.

(Continued)

When a public presentation is to be made the papers required are much the same as in a private presentation. Because of the large quantities required, they will of necessity be printed. As a rule, the documents employed should be as few in number as will properly cover the facts to be made known. If a mass of printed matter is sent out to enquirers, as is frequently the case, it prevents a clear, concise presentation, is confusing, and careful study is required on the part of the recipient to establish the connection between the numerous documents. A busy man cannot stop to do this; others will not take the trouble, and the general result is bad.

For the same reason the text of the prospectus should not be too much broken up by the inclusion of extracts, papers or related matters. If copies of leases, option contracts, expert reports, etc., etc., are to be presented in close connection with it, these should as a rule come after the prospectus proper in the form of exhibits, reference perhaps being made to them in the text. They will then form part of the general prospectus and will be bound up with it, but will not break and weaken its argument.

This does not, of course, apply where an extract, a statement, or a document is so nicely in line with the general context of the prospectus that it continues and strengthens the argument, but only where it would break the connection and interfere with the general arrangement and appearance. Frequently when such closely related matters are brought into the text of the prospectus, they are printed in smaller type and the whole matter is so arranged that these inclusions may be easily distinguished and be skipped by the reader if he desires. In such case the general matter is arranged so that this can be done without losing the continuity of the presentation.

The general style of the printed prospectus should always be good. The very ornate prospectuses occasionally gotten out in green and gold and other striking color combinations, with tinted ink, costly illustrations and a general disregard of expense, are not to be commended, unless required by the nature of the enterprise and the character of the people to whom they are to be presented. They savor of extravagance and suggest gold bricks.

On the other hand, a prospectus on inferior paper, poorly printed, or poorly arranged, is even worse. It cannot be attractive, and therefore fails in the first essential. Almost invariably it will be found to fail in other important respects. Further, if those in charge of the enterprise cannot get up a clean-cut, attractive and business-like prospectus—both as to matter and manner—it is a direct and fair conclusion that their administration of the enterprise will be equally lacking. Such a prospectus therefore not only fails to attract investors, but actually repels them.

A good prospectus need not necessarily be an expensive prospectus. It should, however, be tasteful, well arranged, and of live and attractive appearance. Good side or centre headings for subjects set off the prospectus, prevent a too solid appearance and are an assistance to the reader in grasping the logical connection. Illustrations, if they can be brought in to assist the text, are good and add materially to the presentation. If, however, the illustrations have no direct bearing on the subject, as is frequently the case, they are at the best useless and in some cases are actively detrimental, distracting attention from the main issue and thereby weakening the prospectus.

A cut showing the beautiful scenery of the surrounding country would be irrelevant in a mining prospectus, as would also an illustration of the ancient method of curing rubber in a prospectus of a rubber plantation. On the other hand, in the mining prospectus a diagram of the workings of the mine or an illustration of an existing plant, or a cut showing timber reserves or water rights belonging to the property would be relevant, and, if impressive or attractive, or supplementary to the text, would be helpful. Also pictures of the warehouses or other buildings on the rubber plantation, or of the processes actually used or to be used in collecting, curing and shipping the material might be used to advantage in the prospectus of the rubber plantation.

Sometimes irrelevant cuts are used for the mere purpose of breaking up and lightening a too solid text, but if appropriate illustrations cannot be secured, this is better accomplished by subject headings, paragraphing and other similar means.

The cost of printing a prospectus will vary greatly, from the few dollars expended for a single sheet prospectus of some small undertaking close at hand, and therefore not requiring a full exposition, up to the thousands of dollars expended in the preparation of the handsome mining prospectuses characteristic of such flotations.

If a professional writer is employed to get up the subject matter of a prospectus he will usually advise as to the style and cost of printing. Generally his advice is good and his estimates reasonable. If, however, he is a stranger to the parties for whom he is acting, it is well to get an estimate on the work from some outside printer for "checking up" purposes.

A variance between the figures when such estimates are obtained, even though material, is not necessarily an indication of bad faith on the part of the prospectus writer or a proof of excessive charges. It may be that his printers are capable of producing better and more effective work, and therefore properly charge a higher price. Or it may well be simply a printer's mistake, or the result of different modes of estimating. Such divergences are not uncommon in practice and before a high figure is rejected or a low one accepted, the responsibility and artistic ability of the parties making the estimates should be investigated. Good work can not usually be had cheap and the best of prospectuses may be spoiled in the printing.

In many cases, whether the presentation be public or private, the prospectus will be the only paper employed. Generally, however, one or more other documents are used in connection with it to make a com-

plete presentation. These additional papers will vary in number and nature with the conditions.

Frequently, and in a public presentation almost invariably, a letter to the party to be interested will accompany the prospectus. This may be either a facsimile letter, as is usually the case in public presentations, or a personal letter. This letter, if not too long, will almost always be read, and gives opportunity for a strong presentation of the most vital features of the offering, or of those features which should appeal most strongly to the particular party. This adds a personal element to the presentation that is at times very desirable and which could hardly be secured with the prospectus alone.

At times in a private presentation the owners of an enterprise will not care to submit their financial proposition in the prospectus, or to present it at all until they know that the parties with whom they are negotiating are at least interested in the matter. In any such case the financial proposition will appear as a separate document only to be shown when clearly required.

Many practical reasons may exist to justify such reserve. For instance, it may be of the greatest importance to the owners of an enterprise to secure a few thousand dollars of "quick" money. Perhaps some unexpected obligation has arisen and found them unprepared, or certain properties are perhaps to be purchased, or desirable options to be secured, or inventors to be subsidized, or something else of vital importance to be done and done quickly. The comparatively small sum of money required may in itself

possibly increase the value of the enterprise many-fold. The owners are therefore willing to make almost any concession to secure it, perhaps offering a good stock at twenty cents on the dollar, or even less.

When the money for their immediate needs is once secured, however, the owners are in a totally different position and such sacrifices are no longer necessary. Then they may still wish to sell stock, but on a very different basis, perhaps at fifty cents on the dollar, or even at par. If, then, it is generally known that but a short time previously this very stock was offered at the heavy discount mentioned, investors, without regard to the real value of the stock, will be found very reluctant and perhaps entirely unwilling to purchase at the higher price now asked. This is an unreasonable position on the part of the purchaser, for his investment should be made on the basis of the proposition as it stands, not as it stood at some previous time, but as a matter of fact this would be his position if the conditions were known. It is therefore much better that any such conditions should not be generally known.

Many other circumstances may arise under which it is advisable to reserve the financial proposition, and in any such case a general prospectus is first prepared, giving a forcible presentation of the enterprise as a whole and stating possibly the capitalization of the company, its organization and its purposes, but not going into the details of the financial offer. The sale of stock may perhaps be referred to in a general way, the statement being made that stock of the company is to be sold to secure funds for working capital,

for the development of the property, for the purchase of machinery or for any other purpose that might with propriety be made public; or the precise object for which the money is to be secured might be covered and concealed by the very convenient phrase, "for the purposes of the company."

Then, in addition to this general prospectus, a financial statement is prepared. This is usually very short and much to the point. The principal features of the enterprise having been already discussed in the prospectus, need not be gone into. All that is necessary is the statement that so much money is needed, with usually a brief explanation of the purposes to which it is to be applied, and that so much stock is offered at such a price to secure this money. This financial statement is not given out with the prospectus, but only when the owners are convinced that the parties with whom they are negotiating are interested to an extent that justifies the full presentation.

The general financial details of the company, such as its capitalization, stock or funds in the treasury, property owned, etc., might go in either document with entire propriety. If included in the general prospectus, however, the essential features should be repeated in the financial statement to avoid the necessity of consulting both documents for a full understanding of the financial proposition.

Sometimes in connection with the main or general prospectus a brief preliminary statement will be found advantageous, serving as a "forerunner" to prepare the way for the prospectus. In many cases, if the main prospectus were presented first to a busy man he might

decline entirely to wade through it, or if he did read it, might do so in such a casual manner as to lose, misunderstand, or fail to see the bearing of important and even essential features, and because of this possibly turn down a proposition in which he ought to be vitally interested. To prevent this—if it were suspected that such might be the case—a short digest or résumé of the important features of the enterprise is prepared in a brief paragraphed form so that he who runs may read with much facility. This gives all the essential features of the offering in a condensed, logically arranged and mentally digestible form, that can be taken in at a glance,—so much so that even a preoccupied man seeing it could not fail to get a fair idea of the enterprise and its bearing on his own affairs. If he were not interested, that would end the matter. If he were interested, the attack would be followed up by the more formal prospectus, or in such other way as the conditions demanded.

In connection with the prospectus, such other statements, certificates, reports, assays, analyses, etc., should be secured or prepared as may be necessary to substantiate material facts. The ordinary facts affecting the enterprise, such, for example, as the existence of convenient and plentiful supplies of water and fuel, distances from railroad stations, cost of labor, etc., etc., while they must be fully stated, do not usually require substantiation. Other facts, perhaps of no greater real importance, must be verified. The nature of the enterprise and the conditions will determine what facts require such support.

When an enterprise is presented involving the pos-

session of valuable realty, certified abstracts of the titles of this realty should be provided, with such other evidence as will show its ownership. If the property is held under option, the options themselves, or certified copies, should be at hand. Or if the property is held in whole or in part by franchise, lease, government patent or similar title, either the original documents evidencing the ownership of the property, or duly certified copies should be provided, or be readily accessible. In case of any doubt or possibility of doubt as to the validity of any important feature of such titles, the formal written opinion of a reputable and qualified attorney will be found of much weight and advantage.

In case of an invention, the original patent papers, together with verified copies of any assignments, contracts or agreements in point should be procured. A statement of any interferences encountered in the course of the original applications is pertinent, and, if these have been successfully overcome, gives an element of strength. In any case such a statement will be of assistance to those investigating the invention, enabling them to determine the better as to its scope and the liability of interference or competition when it is placed on the market. The opinion of the patent attorney through whom the patents were secured, as to the novelty and merit of the invention and the strength and value of the patents, is, if favorable, a very helpful feature. If the patent has been involved in any litigation, the fact is of much importance and should be set forth in detail.

It is to be noted in this connection that an "unad-

judicated" patent is looked upon doubtfully in commercial circles. The fact of its allowance is, of course, a favorable indication. It is not, however, in itself conclusive evidence of a monopoly or even of an exclusive right in its own particular field. It may be found that the patent rights are greatly restricted or even practically abrogated by similar inventions then existing, or perhaps conflicting patents may appear later. All that the unadjudicated patent proves is that in the opinion of the patent office the invention in question is a "new and useful improvement" and does not, as far as the examiners can see, conflict with any other new and useful improvement then patented or in course of application. The owners of some prior patent may be of a different opinion, or the owners of another conflicting invention may appear later with claims of priority, or patents may be granted to other similar inventions which subsequently appear. These possibilities—and they are very real possibilities—cannot be foreseen with any certainty.

In any of these cases, the courts must be appealed to and their decision prevails. The patent may, of course, be upheld in every claim. The courts may, however, decide that the patent office officials were in error in granting a patent and the whole thing be wiped out. Or perhaps they may decide against some important features of the patent, or decide that these features were not properly patentable, and thereby destroy the supposed monopoly.

This being true, patents are regarded as of questionable value until they are seasoned by a considerable period of uninterrupted enjoyment, or until their status

is determined by competent adjudication. Therefore, when patents form part of the presentation, every feature that will in any way strengthen them should be brought forward and emphasized.

If an enterprise is in operation and actually paying its way, and perhaps making profits, or if, in other words, it has reached the very desirable condition of a going concern, this condition will naturally be made one of the strongest of the whole presentation. It shows that the enterprise has been carried beyond the experimental stage, proves its commercial value, and presumably indicates that its future and more profitable operation is merely a matter of sufficient funds and good business management. Everything, then, that bears on this feature should be brought out with the greatest possible strength and clearness. If the enterprise has been profitable for a number of years past, a statement should be prepared showing the receipts, expenditures and net profits for each year; and if the profits have been increasing each year, the fact is significant and important and the presentation should be so arranged as to bring it out very clearly. Such a statement, if presented to strangers, should either be verified by the certificate of an auditor, or perhaps of the bookkeeper or owner of the enterprise, or otherwise the books and records should be at hand to be referred to in case of need. The nature of the trade or operations from which this profit is derived should usually be explained in detail, and the reasons for believing that the revenues derived therefrom can be increased and the methods of doing this are relevant and important. A few figures scratched down in a

note book may be a sufficient statement of business operations for a preliminary discussion or for a presentation among close friends, but are utterly inadequate for anything more formal.

If the property or undertaking has undergone expert examination, the report of the experts will, of course, form an important part of the exhibit and should be gotten up in the best possible shape. No matter how good the report, if it is untidy, badly expressed and poorly arranged, it will lose half its weight even though signed by a competent man—if a competent man would sign a report of the kind. If in addition to this, as is sometimes the case, the signature of the expert is omitted entirely, or put in with a typewriter on the supposedly original copy, the report is worse than useless. It shows incompetency in the expert and in his employers, and should justly discredit both the undertaking and its presenters.

Any contracts or agreements relating to the property or enterprise, or to its operation, should, of course, be available, either in the original or in certified copies, and, generally, every essential feature of the enterprise should not only be presented, but if it can be strengthened by outside statements, opinions or elaborations, should be so strengthened to the utmost. All these precautions may not be necessary, but it is impossible to tell in advance just what will be demanded and when, and as a matter of good business prudence the entire ground—as far as may be without undue expense or trouble—should be fully covered.

CHAPTER XXVIII.

THE PRESENTATION.

Private or Public.

Whether the presentation of a particular enterprise will be private or public is determined by the conditions. If the undertaking is not large, or but comparatively few persons are to be interested in it, the presentation will naturally be private. If the undertaking be too large for a few persons to carry, or if for other reasons a number of persons are to be interested in it, the presentation will as naturally be public.

A public presentation is costly, requires much skill, experience and preparation and its conduct is difficult. A private presentation, on the other hand, is simpler, less expensive and usually more within the scope of the owner's or promoter's abilities. Then but a few men are to be dealt with, the formalities are simple and the presentation may be made on such scale and with such expense or lack of expense as the parties in charge see fit.

The public presentation must of necessity be used in whole or in part for the very large financings characteristic of modern industry. It is also used very generally for conservative enterprises of a semi-public nature, such as banks and trust companies. It is much

used in financing the larger speculative enterprises. It is not adapted, however, for the ordinary enterprise of a conservative character, as such an undertaking will neither bear the expense of a public presentation nor afford any adequate basis for the extravagant claims and representations usually deemed necessary to secure the smaller public subscriptions. The private presentation is, then, for most enterprises clearly and unmistakably indicated.

In some cases, however, the character of the enterprise, or the conditions surrounding it, or the results desired, are such that it may be presented by either method, and then the two must be weighed and that method selected which offers the greatest benefits for the particular presentation.

The advantages of private presentation have already been briefly stated. Its expense is light, its conduct is within the ability of the ordinary promoter and the whole thing is "manageable." A private presentation is, however, sometimes objectionable from the very fact that it is made to a few men. These few men feel that they are putting in the money that makes the enterprise and that they should be rewarded in accordance with the importance of their part. Their ideas of the importance of this part are apt to be liberal. It is but seldom that they accept the owner's proposition as it is made. On the contrary, they investigate with care, determine the merits and value of the enterprise, estimate just how much money is required, ascertain perhaps the personal necessities of the owners or promoters, and the firmness with which these latter hold the enterprise, and then, in the light

of this knowledge, make a counter proposition which is very different from the one made to them.

At times when the enterprise is exceptionally attractive, or is of a very solid nature, and is firmly held, money may perhaps be secured from strong financial men on the terms proposed by the owners, sometimes even when these terms are really unreasonable. Such conditions are, however, unusual, and as a rule the parties owning or controlling an enterprise must expect to meet the demands of the men with money and this usually involves parting with the control of the enterprise in exchange for the money required. A number of people may, it is true, be appealed to by a private presentation, but at the best the number reached cannot be large and the difficulties of securing money on the owner's terms still exist, though perhaps in a less degree.

If, then, the parties owning the enterprise are not themselves financially strong, but still wish to retain absolute control of the enterprise, or desire to conduct it without dictation or interference from the men who put in the money, they will usually be forced to make a more or less public presentation.

It is to be noted that a public presentation usually contemplates a large number of small contributions. Some of the enterprises financed in whole or in part by public presentation, such as banks, trust companies and the great industrial enterprises and combinations, expect and secure large individual subscriptions, but the usual speculative enterprise, though requiring a large amount in the aggregate, appeals for and expects to secure but a small amount from the individual subscriber.

The success of such an appeal depends upon the fact that there is a very large class of people of moderate circumstances to whom the disposition of their savings is a matter of much perplexity. Usually, though not invariably, these savings are small in amount. Something must, however, be done with them. To hoard them at home is unsafe and extravagant. They should be out working for their owners and bringing in a more or less adequate return, but how to put them out safely and profitably is a difficult problem. The modest three or five per cent. of the ordinary conservative investment is not attractive. Then, if these people can be convinced that an enterprise is reasonably safe and that by investing therein they will secure at least eight or ten per cent., with good prospects for much larger returns, and with perhaps a doubling or trebling of the original investment meanwhile, their money is apt to be contributed with freedom.

Obviously under these circumstances money may be obtained on better terms for the owners of the enterprise than would be the case in the usual private presentation. A man putting in perhaps \$100 in an enterprise calling for hundreds of thousands is a small factor. Usually he recognizes this and neither expects nor receives special consideration. The proposition framed by the owners of the enterprise is made to him to be accepted or rejected as he sees fit, but in either case without modification. If he likes the offered enterprise he may invest; if he does not, he can let the matter alone. If he decides to invest, he pays his money and then goes on about his more immediate and important private business, leaving the managers of the enterprise

to run it as they see fit. If they do this with even reasonably honest and able management, there is little fear of interference on the part of the stockholders. These latter want profits, but beyond this do not concern themselves with the conduct of the company. The managers have practically a free hand.

So far the advantages of the public presentation are patent. Better terms and greater freedom of management are secured than would usually be possible in a private presentation. On the other hand, as each subscription is small, and as each subscriber must be worked up individually to the pitch of investing his small quota, extensive, expensive, continued and able work must be done to accumulate the large total amount required. Also in case the enterprise is not profitable, or but moderately so, the inquiries and importunities of these numerous small stockholders are often annoying. Even when successful the large number of stockholders with their individual stock certificates, frequently transferred, and with the necessary notifications of meetings, payments of dividends, etc., etc., involves much bookkeeping and complexity that would otherwise be unnecessary.

The advantages of the public financing are, however, clearly marked, and where they are indicated by the nature of the enterprise, or desired by the parties in control, are easily sufficient to overbalance the incidental disadvantages.

The public presentation is especially adapted and is commonly used for speculative enterprises in which the risks are excessive and the rewards in event of success are proportionately large. Particularly is it

employed in those speculative enterprises in which not only are the risks desperate but the basic enterprise is of doubtful merit and the surrounding conditions are of equally uncertain commercial availability.

For instance, a promoter secures control of a mining prospect. It is located in some remote part of the West, is undeveloped, unequipped and of more or less uncertain value. The promoter is not an expert in mining and has no money to develop the scheme himself.

If in such case the promoter took his enterprise to men with money, they might possibly go in with him, but if they did, would not only take the lion's share of the profits, but absolute control of the enterprise as well. They would put in only enough money to determine the value of the prospect and devote all these funds to development on an economical and conservative scale. The promoter would neither control nor cut any great figure in the undertaking.

This would not suit the average promoter and he would probably resort to a public presentation. He must then raise sufficient money for advertising, printing and office expenses. If he cannot do this from his own resources, he must appeal to someone else for funds. The party advancing the money in such a case would, however, look for profits from the sale of stock, not from the development of the prospect, and the promoter would therefore get his money on very different and much better terms than if he offered the mine itself. He would also keep the control.

Having secured this first money, the whole matter

is then one of presentation. Handsome offices are rented, the promoter's imagination and the country surrounding the "mine" are ransacked for "facts," attractive advertisements are printed, glowing prospectuses are put forth, a company is organized with a million or so of capitalization, stock is issued and put on sale at a few cents a share, and the campaign is on.

If the presentation is good the promoter's troubles will now near their end. The smaller investor cannot really investigate the offering. He must judge of the enterprise almost entirely from the facts supplied him, and as these facts are furnished by the promoter, they are apt to be very favorable to the enterprise. Also the astonishing opportunity to secure dollar shares at a few cents each always seems attractive, and if the promoter is really skilful in his work, subscriptions will begin to flow in. If he is not skilful the promoter will probably have a great deal of trouble in meeting bills about this time, and the "bright and halcyon beginning" will end suddenly and decisively.

If successful the money secured is drawn upon for the promoter's compensation, for the payment of office and general expenses and for the continuance of the advertising work. Any balance is devoted to the development of the prospect. This work is duly heralded as an additional inducement for prompt investment before the always expected wonderful strike has been made and the price of stock thereby raised.

Not only does the smaller investor find it impossible to investigate an offering of this kind closely, but it is equally difficult for him to maintain supervision over the progress of the enterprise thereafter, and the

promoter is practically left in complete control. Also in case of disaster to the enterprise, whether from mismanagement or even from fraud, the promoter's position is again as desirable as it could be under such unfortunate circumstances. Each stockholder is but one of many and has but a small amount at stake, and lacks not only sufficient incentive, but usually the knowledge and ability to enable him to either recover his lost investment or bring punishment on the heads of the offenders. Nor, as these small stockholders are almost invariably widely scattered, is there any likelihood of concerted action against the management.

It is easily seen that no single stockholder having ten, twenty-five or even one hundred dollars invested in an enterprise located some hundreds or thousands of miles away, could afford to employ lawyers and institute legal proceedings to protect or recover his investment. Nor would it be any more profitable or practical for him to hunt up his scattered fellow stockholders and unite them in opposition to or prosecution of the parties in control. Either plan would involve him in expense, largely in excess of his personal investment, and would be literally throwing good money after bad.

Under these conditions, even in case of actual fraud, no action of any kind is usual. The stockholders protest as vigorously as their ability as correspondents and their distance from the scene of action will permit, and when this proves ineffective, pocket their losses and of necessity charge the whole matter up to experience. No one else is in a position to act or has any reason for acting, and the whole matter drops.

The light-fingered gentry of the financial world are well aware of the possibilities of these conditions, and as a matter of fact hundreds of thousands of dollars are secured from the smaller investors of the United States every year by absolutely fraudulent presentations. But little if any punishment is ever inflicted upon these offenders. The swindlers who operate these schemes know just how far they can safely go, and when that point is reached the "time for disappearing" has arrived and they are no longer in personal evidence.

An interesting case of the kind came under the writer's observation some years since. A "gentleman" evidently versed in the industry originated and proceeded to put in operation a plan for providing homes for people of moderate means by a series of small payments—a modification of the building association idea. The association was to be national in its character and build homes for its members in any part of the United States. The payments were absurdly inadequate and long drawn out, and just how they were to pay for the promised homes was not made quite clear. The company was, however, in some mysterious way to perform the part of fairy god-mother, and this seemed to be satisfactory to all parties. The general idea was attractive and sufficiently plausible to gain the confidence of people not used to financial calculation.

The scheme was advertised well and extensively and responses were numerous. Also the majority of those who responded, including some who apparently came to scoff, remained to be preyed upon, and large

amounts of money were secured by the promoter of the scheme.

The details of the undertaking were ingeniously arranged and it was extremely difficult to prove that it was fraudulent—the more so because of the further ingenuity of its promoter in explaining, evading and keeping out of the way of enquirers. Complaints were frequently made by those investing money, and time after time the Government post-office agents were called upon to investigate. In every case they were met and baffled by the suave explanations and protestations of the proprietor of the scheme. This was backed, when it became absolutely necessary, by an offer to refund the money of the complaining party, and for nearly two years the swindle prospered unchecked.

Finally the postal authorities became impatient and issued a fraud order forbidding the delivery of mail. This effectually cut the promoter off from the profits of his scheme. It also as effectually shut his victims off from the promoter. Their letters were returned unopened, advertising ceased, the promoter promptly disappeared and the incident was closed. No prosecution of the guilty party ever took place or was even attempted. For a time the promoter's nearby contributors called at his former office address for information, but he was gone—no one knew his whereabouts or could tell anything about him, and the visits soon ceased. The loss to the victims in this case will never be known—except in the very improbable event of a confession from the promoter—but they undoubtedly ran far up into the thousands.

In swindles of this kind the promoters generally spend a decent interval in semi-retirement after their enterprise is closed by the action of the authorities, then emerge under some new name, rent offices in a new location, and come out with another plausible scheme to relieve the same or other victims of their accumulated earnings.

The numerous swindling enterprises of this general nature are particularly contemptible as defrauding the smaller investors who have no adequate means of protection—save by a strict avoidance of the field of investment—and to whom the loss is nearly always a matter of suffering or deprivation. They also have a very unfortunate effect on the whole system of financing by public presentation. It is hardly to be expected that the ordinary individual can discern between the glowing statements printed by a concern that is financing a legitimate undertaking, and the still more glowing statements printed by a concern which is financing a fraud. As a consequence, the smaller investors are suspicious of all enterprises seeking their money by public presentation, and the work is rendered far more expensive, difficult and meagre of results than would otherwise be the case. It is therefore a matter of peculiar gratification when swindlers of this type are caught in the meshes of the law—as does occasionally happen—and reap the proper rewards of their misdeeds.

CHAPTER XXIX.

PRIVATE PRESENTATION.

Among Friends.

When an enterprise is to be financed by private presentation, the promoter—the term as used here including anyone actively interested in the financing of an enterprise—must decide whether to appeal to those with whom he is in personal touch, such as friends, associates or acquaintances, or to strangers. Speaking generally, whenever the conditions will permit, the presentation is best made to friends, for a man should possess a standing and reputation among his acquaintances which is established with difficulty among strangers, and he should therefore secure money at home with an ease not to be found elsewhere.

The promoter should, however, be very sure that the enterprise presented among friends is a sound one. Friends will go into the enterprise largely because of their confidence in the promoter. They do not scrutinize his offering so closely as that of a stranger, they invest more freely, and naturally they demand a special consideration and protection not accorded to those actuated purely by business motives. Then, if the enterprise is not a success, these friends feel that their confidence has been abused, and display but little

charity for the promoter. If in addition it turns out that the enterprise was not even an ordinarily sound one, but involved more than the usual business risk, the promoter's position is indeed unhappy. Not only will his business standing be affected, but his social relations as well, and unpleasant suggestions of improper management or even of fraud may be whispered about.

The conditions are, of course, different when the promoter's friends go in with a full understanding and express recognition of the risks involved. In that case they have no real ground for complaint in case of failure. Even then, however, there will be trouble. The promoter cannot perhaps be openly blamed, but his judgment is discredited, his business standing is injured, and the general effect is far from good.

An unsuccessful enterprise, it is true, is liable to make trouble for its promoter, no matter whether floated among friends or strangers. Among strangers, however, failure, while still unfortunate, is neither so unpleasant from a personal standpoint nor so injurious from a business point of view. Among friends it may perhaps involve the promoter's whole business career. Among strangers it certainly does not enhance his reputation and prospects, but it is not apt to be so disastrous. Strangers expect fair dealing, but nothing more, and in case of failure the promoter will meet with a much fairer and more dispassionate judgment among these strangers than he would among his own friends, and—provided only that it is an honest failure—can retrieve it more quickly.

Also it is to be borne in mind that the supply of

friends is limited, while the reserve of strangers is inexhaustible. Therefore, if any risks beyond the ordinary are to be taken, it had usually best be among these strangers where the loss of a few or even a score from among the promoter's clientele is a matter of no great moment, and where a failure is not so far-reaching in its consequences.

Financing among friends, if the conditions are right, is of the easiest possible. The enterprise must be suitable, the proposition fair, the friends must have money to invest, and the promoter possess their confidence. Given these conditions and the promoter may go quietly round among a few of these friends, present the matter to them and get his money. A pencil and a few scraps of paper take the place of a prospectus; the personal argument does the rest. The usual difficulties of financing do not exist.

For instance, the captain of a New York harbor towboat sees a chance to buy a tug and start in business for himself. He lacks a few thousand dollars of the amount required and undertakes to raise this money among his friends. He is known by these friends as an honest man and a safe and successful captain. His campaign for capital is simple. He usually has a shrewd suspicion as to where his money may be found. After supper some fine evening he lights his pipe, puts on his hat and goes after it. A brief explanation, a few pertinent figures and statements, and a very simple proposition constitute the entire presentation. A few friendly calls will probably give him all the money he requires.

The same easy-going method is much more fre-

quent than would be supposed in the circles of "high finance." Not uncommonly some "captain of industry" or other man of business rated up in the hundreds of thousands or millions perhaps, will take up an attractive enterprise, and with nothing more elaborate than a lead pencil, a note book and the natural advantages of his position will, in a few hours' time, finance it among his business associates to the extent of tens and even hundreds of thousands of dollars. Occasionally the formality of a personal visit is dispensed with and the whole matter is settled over the telephone, the promoter not even leaving his office. Legal assistance, formal adjustments, and well-drawn contracts may later conclude and fix the negotiations, but the matter is settled for all practical purposes before these formalities are reached.

To illustrate the general ease of securing money among friends when the conditions are favorable, the case of a young and very successful firm of neckwear manufacturers may be instanced, who some years since incorporated their business. There were but two in the firm, and while they did not need more money in the business, they did need another incorporator in order to comply with the requirements of the law. A friend was asked to act and willingly agreed. The two parties thereupon not only made this friend pay the full par value of the few shares of stock which, as an incorporator, they were forced to let him take, but absolutely refused his rather urgent request for a larger allotment. They could have secured any reasonable amount of money from him and from other friends for the mere asking.

Offhand financing such as instanced is not uncommon and it may be laid down broadly that when a good business man presents a meritorious enterprise to friends who are in a position to invest, he will, if his proposition is fair, get all the money he needs. These are the most favorable conditions for financing, and just as they are departed from, so does the difficulty of financing increase.

Usually some of these conditions are lacking, or exist only in incomplete form. Possibly the promoter himself may not be looked upon with entire confidence. Possibly he may have the complete confidence of his friends, but the enterprise will be looked upon with doubt. Possibly both the promoter and the enterprise are all right, but the stringency of the money markets makes financing for the time impossible, or perhaps the financial condition of the particular friends is such as to make it inadvisable for them to invest.

If the party himself is an obstacle, either on account of his personal character or because of his doubtful or unproved business ability, the situation is difficult. Then, if the enterprise is to be financed among those who know him, the promoter must resign himself to the loss of its control, placing its management in the hands of men who command the trust his acquaintances refuse him, or else must place this control directly in the hands of the acquaintances themselves so as to insure them against any mismanagement or improper management on his part.

If the enterprise itself is looked upon with doubt, the promoter's ingenuity will be taxed to remove the unfavorable impression. He must then be prepared

to demonstrate the safety, the suitability and the profitable nature of his enterprise. Knowing the situation he should be able to do this with more or less conclusiveness. If he cannot, the enterprise is not one that he should have presented to friends at all.

If the difficulties in the way are financial, the promoter will be governed by conditions. If the parties approached actually have no money to invest, the matter, of course, ends right there as far as they are concerned. If it is merely that the times are hard and the parties appealed to are doubtful whether they can spare money for investment, it then becomes a matter of presenting the enterprise so persuasively that their reluctance shall be overcome, or of delaying its financing until times are better, or of approaching other people.

The method, when presenting an enterprise among friends, will vary greatly with the conditions. Naturally, other things being equal, the immediate friends of the promoter will be approached first. If the enterprise be in a line of business with which they are familiar, probably no prospectus will be required, a brief written or even verbal statement of the enterprise, showing its condition and the amounts involved, answering all requirements. As the circle widens, however, and the presentation is made to more remote friends and acquaintances, more formality must be observed, until finally the ordinary presentation is reached, with its prospectuses, estimates, statements, etc., etc.

Usually when an enterprise is presented to friends, if these latter are not able or do not care to invest,

or are unable to contribute the full amount themselves, they will suggest or introduce friends of theirs who are likely to be interested. In this case the "basis of confidence" possessed by the introducing friend is transferred to and enjoyed by the promoter, and he can work amongst these friends of his friends—who are now his—to almost the same advantage that he can among his own personal associates. Or friends may act directly as agents for the promoter and get money for him, perhaps from a merely friendly interest or perhaps to earn a commission. Either motive is proper and entirely legitimate.

Frequently in the presentation of an enterprise at home, local personal pride or interest may be appealed to with much effectiveness. If the place be a small one and the enterprise of importance to it, as a local sawmill, a foundry, a newspaper or an opera house, the advantages accruing to the town from its establishment may be used as arguments for subscription. Possibly the matter is one of convenience to the residents, or something that will attract new residents, or perhaps place the town ahead of some neighboring and competing village, or it may be that it merely advances the general importance and prosperity of the place. Any or all of these facts may be used as legitimate and effective means for securing funds. The field is one that offers much scope for ingenuity, not only in the discovery of advantages to be derived from the proposed enterprise and the use of these discoveries as a means of securing subscriptions, but also in the disposal of objections that will almost certainly arise.

For instance, a sanitarium may be proposed by the local physician of some healthful mountain village. The establishment of such an enterprise will bring numerous patients, who are generally people of means, to the sanitarium. Supplies will be purchased in the town, work will be provided in the erection of the buildings, employment will be afforded for the inhabitants in and about the sanitarium. Also frequently the patients will be accompanied by friends who must take up their residence in the village, and the money brought in by the patients and their friends will add materially to the prosperity of the place. All these facts are material and important and should be strong arguments in a campaign for local subscriptions to the enterprise.

On the other hand, opposition to the plan may develop on the part of property holders who fear that the presence of the invalids at the sanitarium and their travelling to and from the village may have a very harmful influence on the price of realty and tend to check the growth and reputation of the place. This is at times a very real and serious objection, particularly if the sanitarium were for patients suffering from tuberculosis, and could only be overcome by tactful work on the part of the promoter. He might show in the first place that the possible injury from this source was greatly overestimated, that the location selected for the sanitarium was too far from the village for it to have any direct effect, and that the sanitarium could have a name of its own to more effectually separate it from the village, and finally that the possible dangers were completely overbalanced by

the advantages that would accrue from the establishment of the sanitarium as proposed.

If the enterprise appeals to or will benefit any particular industry or line of business, that fact may be used to advantage. If a bank is to be started, the merchants and manufacturers of the place who will find the bank a convenience should be easily induced to render it their support. Or if a coal mine is to be opened, the local railroad which will benefit by its shipments may possibly be induced to assist—not in the very dubious way that seems to prevail with some of the great coal roads of the East, but on the basis of good hard cash subscriptions, or perhaps in the way of sidings or other shipping facilities. Or frequently a banker will subscribe to an enterprise which promises deposits for his bank. Or if a grain elevator is to be established, the farmers of the neighborhood who will advantage by its erection may be interested. Or a creamery which opens a new market for their milk will appeal very strongly to these same farmers, and on any reasonable basis will almost invariably receive their support.

This should also be the case with distilleries for the production of denaturized alcohol. The plants for the production and preparation of this alcohol demand too large an investment to be within reach of the individual farmer. They are, however, easily possible by co-operative effort, and open a new and very profitable avenue for the disposal of large quantities of the farm products, which are now of but little if any value.

Also very frequently the offer to some special person

of a position in the new enterprise will be a potent means of securing contributions. This should not, of course, be done to the injury of the enterprise by the installation of inefficient officials, but properly used, is a strong and legitimate inducement for either direct or indirect subscriptions. If a desirable opening is offered a young man who is looking for a position, or who wishes to better a position already held, the offer being conditioned on a subscription of some fixed amount to the enterprise, the subscription—if the conditions are at all favorable and the amount within reason—is very apt to be forthcoming. If the young man cannot subscribe himself, he will convert himself with much promptness into a very active and interested agent of the enterprise, and some relative or friend can usually be found to help both the young man and the enterprise by making the requisite subscription. Or the assistance of an influential man can sometimes be secured by the offer of a position, such as the presidency or treasurership, or some other advantageous connection with the new enterprise. Conversely, the mere effect of having some specially prominent, able or influential man connected with the enterprise is at times of sufficient importance to justify the offer of a remunerative or advantageous position. Such men give solidity to the undertaking, create confidence in its future and are a material aid in securing subscriptions. The general idea is capable of many variations and is much employed in practice.

In any presentation of the kind among people who are acquainted, the effect of good fellowship and of the desire to go with the crowd cannot be over-

estimated. The idea should be emphasized as strongly as possible that all are going in on the ground floor together, and that the opportunity of getting in with the rest should not be missed.

Enterprises of very modest merit are not infrequently financed almost solely on this basis. John Jones may not have the faintest intention or desire of taking part in the organization of a bank or a building association, or a factory, or a gun club. If, however, some of his friends are going in and the fact is properly brought to his attention, in nine cases out of ten, in the absence of some material reason for not doing so, he will join the movement. This is especially true when those who are going in are particular friends, or people whom he admires or respects.

Sometimes when working along these lines the financing of an entire enterprise will hang on the possibility of getting someone to make a start. Those approached may want to go in, but dislike to take the lead, or perhaps they are uncertain, or even may not want to go in at all. If, however, anyone can be induced to make the initial "break" the rest will follow. Then the critical point is to secure the first subscription. This sometimes gives room for the display of much ingenuity on the part of those in charge of the enterprise.

In a case in point in the writer's experience, promoters were trying to raise money among their friends to develop a deposit of asphalt supposed to be very valuable for varnish making. The friends approached hesitated because of their ignorance of the industry and more particularly because the varnish value of the

asphalt in question had not been demonstrated on a commercial scale.

The promoters worked with much persistence, but it seemed impossible to get the matter started. Finally one of the gentlemen appealed to, put the matter concretely. "I don't know that your asphalt will make varnish. I believe that the stuff is in the deposit, that it is there in sufficient quantity, and that you can get it out profitably, provided it is of the proper quality to make varnish and will command the prices you claim, but this has not been proved. Now show me an order from some varnish establishment for a carload of the stuff and I will put in a thousand dollars."

The problem then presented to the promoters was a difficult one. The varnish makers of the country had their own sources of supply, and much preferred that others should not be opened. They could not, therefore, be looked to for assistance. No other manufacturers would use varnish asphalt in such quantity. Nothing daunted, however, the promoters took counsel together and after due consideration set to work to organize a varnish company. The capitalization of this little company was modest, but the promoters were quite successful in securing subscriptions for its stock, and as soon as the new company was sufficiently far enough along to begin operations, its first business transaction was to give the promoters an order for a carload of asphalt. The promoters came back to the gentleman with this requisition. While it is somewhat doubtful whether the order fully met the spirit of the gentleman's demands, it did secure his subscription. Other friends joined in and the amount desired for the development of the deposit was secured.

Frequently money for an enterprise can be obtained in a neighborhood by an even more direct use of the co-operative idea. Say a sawmill is to be started and the sum of five thousand dollars is required for the installation. The parties in charge of the enterprise thereupon start in to get ten men to put in \$500 each. The fixing of a definite sum and the community and equality of interest thus established appeals strongly to those approached, and very frequently carries the day when it could not be carried on any other basis.

It is hardly necessary to say that in a friendly presentation of the kind here considered, a very full exhibit of the enterprise is nearly always advisable. Its soundness, its suitability, the advantages to the town, its reasonable profits, its speculative possibilities, the absence of risk—all these must be brought out strongly and fully. Also if such is the case, the fact that small salaries are to be paid until a dividend basis is reached and the general idea that no one derives any profits till profits are made for all, may be used to much advantage.

In addition to this, it is also desirable, though not always advisable, to show exactly how the promoter comes into the enterprise. If he is bearing the heat and burden of the day solely for the good of the enterprise, that fact should be clearly understood. If he is putting in his money on just the same basis as the others, without any profits or advantages that the others do not enjoy, these conditions should be known. If, however, he is to receive any special profit, payment or other consideration, the fact should usually be stated. Certainly it should never be concealed.

Possibly the promoter may be working for some position in the enterprise. If so, the motive is entirely legitimate and, if he be suitable for the position, should not be objectionable to his friends. Or perhaps his profits are indirect, as where a hotel, a sawmill or a creamery to be established will open up a profitable market for his wares or products. Or perhaps some property of his is to be taken over by the new enterprise. Or perhaps he is to receive a stock or even a cash commission for his services. Whatever the profit or motive, it should be known. To conceal from friends the fact that a profit is being made is the height of folly. Sooner or later the matter is almost sure to be discovered, and may perhaps result in a very serious discrediting of the promoter. Promoters' profits, if reasonable, are well earned and entirely justifiable. If, however, they are concealed at first and are then later discovered, the proceeding bears an air of trickery and underhandedness very hard to dissipate.

In many cases, and perhaps most cases, if the promoter's profits be reasonable and the matter be tactfully handled, no objections to these profits will be made. At times, however, it must be confessed, most unreasonable antagonism is aroused. Then all the promoter's tact and ability will be required to carry the matter through successfully. Possibly if opposition is anticipated the promoter, while admitting profits, if the matter comes up, will not acquaint his friends with the amount of these personal profits. He is under no obligation, either moral or legal, to do so. Or, if he deems best, he may refuse absolutely to give any information. He is well within his rights

in so doing. What he must guard against is the representation, either expressed or implied, that he is not making profits. Any such misrepresentation is not only bad faith but might make the promoter legally liable to his associates for his profits. The general subject of promoter's profits has been already treated in a preceding chapter—Chapter XXIV, "Manner and Matter of Presentation." All that is said there applies even more strongly when the transactions are among friends.

CHAPTER XXX.

PRIVATE PRESENTATION.

Among Strangers.

As already stated, when the conditions are right a good enterprise is best presented and financed among friends or acquaintances of the promoter. It sometimes happens, however, that the conditions are not right and application must then be made to strangers.

Occasionally, for instance, a young and inexperienced man will fail to finance a good enterprise among his friends merely because they look upon him as still a boy and are afraid to trust his untried business judgment. Or perhaps the promoter has been unsuccessful in some other enterprise financed among his friends and on that account alone fails to secure his money. Or again, he may be entirely successful in his own line of business, but the enterprise in question may be outside this line, or possibly on a much larger scale, and fail because his friends' confidence does not extend so far.

Or sometimes a home financing will fail because of the absolute familiarity of the promoter or of the enterprise to the residents. A town boy will make some important discovery and appeal to his elders for money for its development. They have known "Jack" or "Bill," as the case may be, all their lives, have

never seen anything unusual about him, and therefore do not believe in his invention. If, then, it is to be financed, it must be taken among strangers who will base their opinions on the merits of the invention, not on their knowledge of the inventor.

Or perhaps some village resident of a utilitarian turn of mind will discover that a well-known ledge of rock is a fine building stone requiring only development to make a most valuable quarry. The ledge has been familiar to the people of the vicinity for generations. Stone is probably overplentiful in the neighborhood, anyway, and the idea that the particular ledge is any better or more valuable than the mountains of stone around it strikes them as absurd. The new quarry must then be financed elsewhere if at all.

Also, certain elements of suitability must enter in, whether the enterprise be presented among friends or strangers. It is obvious, for instance, that the enterprise must be within the means of the parties approached. A shipyard, a rolling mill or a connecting railroad, no matter how desirable or how profitable, could not be financed by the residents of a little fishing village in which perhaps the wealthiest inhabitant is possessed of but a few thousand dollars. The enterprise is beyond them, and the large aggregations of capital elsewhere must be drawn upon if it is to be financed.

Again, an enterprise must be adapted to the environment of the people to whom it is presented. A plan to establish a shipyard would not ordinarily appeal to the people of an inland city, nor would a dry placer process for recovering gold appeal strongly to

the agriculturists of southern New Jersey. Both enterprises might be highly meritorious. The people are not, however, familiar with the conditions which would enable them to judge, and, the operations of the enterprises being far distant, they would have no confidence in the enterprises and would not invest their money.

Or again, as a rule, an enterprise that may only be used to advantage in connection with some special business or industry, must be taken to that business or industry, or to people familiar with it, for financing. For instance, an improved method of canning meats, though of admitted value, could hardly be financed in a western mining town. Neither would the same people be interested in a mechanism for weaving carpets, nor a new method of decorating tiles, nor even in an improved drop forge, no matter how valuable the underlying ideas might be.

When the conditions are such that the enterprise must be financed outside the circle of the promoter's own friends, it is to be hoped that the presentation can be made to strangers living in the same place or the same part of the country as the promoter. If not, the expense and difficulties of the work are usually greatly increased.

This is, however, not always the case. Sometimes a presentation away from home may be made by letter quite as advantageously as in person and sometimes even more so, and then the expense and trouble are reduced to a minimum.

For instance, some obscure chemist may discover a new and very desirable preservative for meat—some-

thing low in price, easily applied and entirely unobjectionable on the score of healthfulness. Such a discovery would be of very great value and ought to command a ready reception and a liberal price. It would, however, appeal directly to but a limited class of people, and the most important of these would be the great packers. Obviously, then, application should be made to them first of all. If, however, the discoverer went in person to Chicago, Kansas City, or any other packing center, he would find the great packers busy men, and, unless suitably introduced or favored by fortune, would hardly get further in his quest than an outer office and an interview with a minor and entirely inadequate packing house official. He might not even get past the office boy, and should he by some means reach one of the principals, it would usually only result in a reference to some one else in whose department the matter lay.

In any such case application by letter would be preferable. The discovery would be an important one for the packers and short, concise letters addressed to the managers of the various large packing houses, or even addressed to the concerns, would be referred to the proper parties and in almost every case would receive quick and sufficient attention. If not interesting to the packers, the matter would be turned down with much promptness, but also usually with all due courtesy. If of interest, the letter would probably lead either to an invitation to visit the parties writing, or to a visit from a representative of the particular packer. In either case the discoverer would secure his interview at a minimum of expense and on a most favorable basis.

In some cases a matter of the kind may be consummated entirely by correspondence without the necessity of other personal action. For instance, an inventor recently devised a new and, as he believed, an improved shoe-lace. Such an invention might perhaps be developed as an independent enterprise, the lace being manufactured and sold to the shoe dealers. In the present instance, however, the invention could be handled to better advantage through some one of the great shoe manufacturers and the inventor therefore decided to present the matter to them. It was then necessary to bring the lace to their notice. A personal visit to each of the prominent shoe manufacturers of the country would have involved more expense than the inventor could afford. Also a matter so directly applicable to the business in which a man is engaged will usually secure consideration without the personal element ordinarily necessary in financing. In the case considered it is not probable that a visit from the inventor would have been as effective as correspondence. Certainly it would not for the first presentation. Letters were therefore written, samples were sent, and, it must be admitted, the results were disappointing. If, however, the lace had been worth adopting, it is almost certain that his letters would have led to business. As it was, the matter was turned down with the least possible expense and trouble to the inventor.

In preparing for the presentation of any such matter by correspondence, it should be borne in mind that the parties appealed to are usually experts in their lines and that a lengthy dissertation on the merits, the application and the advantages of the new invention is

not necessary. Business men are, it is true, occasionally obtuse as to their general interests—as in the oft quoted case when the Bell telephone and its stock went begging at prices now hardly credible—but as a rule they are quick to see the advantages of anything particularly applying to their own line of business. In the case of the shoe-lace, it would be entirely superfluous to go into the merits of the lace in detail, as any man with sufficient business ability and knowledge of the industry to be at the head of a large shoe business could see at least as quickly as the inventor himself its possible applications. The letter then should state as briefly as a clear presentation will permit, just what the invention is, what it does, what the inventor wants done, and nothing more. The inventor might perhaps not see fit to make any proposition or discuss terms in this first letter at all, leaving the matter open for future adjustment if his correspondent is interested. Presentation by letter is discussed further in the chapter which follows.

When an enterprise must be presented away from home and correspondence is inadequate, the promoter must usually of necessity take it himself. If he has friends who will present the matter for him, either for the sake of friendship or for a share of the profits, the arrangement may be highly desirable. As a general rule, however, the owner of an enterprise cannot safely place it in the hands of others for presentation, and more particularly when this presentation is to be made in some place too distant for his personal supervision.

The general problems encountered in financing

among strangers are the same without regard to location. It will therefore be assumed for the purposes of the present consideration that the promoter, having found it impossible to finance his enterprise at home, has selected New York as the city in which it is to be presented.

The first suggestion to anyone intending to present an enterprise in New York City is in line with Iago's sage advice, "Put money in thy purse." The financial centers are exceedingly expensive places in which to live and do business, and while the enterprise may be financed quickly, it usually is not. There are brilliant exceptions, but the general experience of enterprises brought to New York for financing is one of continued and discouraging delay.

As a matter of fact, any sound business enterprise of merit, if at all suitable in its character, can be financed in New York City. Great numbers are financed there that do not possess even these elementary requisites. The length of time that a financing will require is, however, extremely problematical. If the conditions are favorable, if the right parties are encountered promptly and the matter be desirable, the whole thing may be practically arranged in the course of a few days or even a few hours. On the other hand, months and even years may be required. In one case well known to the author an enterprise of merit dragged along for ten years and has, now, after numerous trying vicissitudes, but just come in sight of the coveted goal.

Because of this uncertainty and because an enterprise cannot be presented to advantage when the pro-

moter is suffering from a personal lack of money, parties coming to New York for the purpose of financing enterprises should either provide sufficient funds for a long siege or else arrange for and execute a prompt retreat when the funds they do have run short.

To come without proper financial provision is not uncommon among a certain class of owners or promoters of enterprises, and more particularly among inventors. The man who does so is not only liable to meet with humiliating and highly disagreeable experiences, but is also heavily handicapped in his work from the start. Success under such circumstances may be possible, but it is not probable, and the unlucky promoter—while not likely to lose much, because he has not much to lose—will almost certainly find that he has come on a fool's errand.

On the other hand, it may be said that extravagant expenditures are not in any way essential to the financing of an ordinary deal in New York City. In any such case the style in which the party lives while presenting the matter cuts but little figure. If some transcontinental railroad is to be financed, or a packing house combination is to be arranged, or some other negotiation involving millions of actual value is to be consummated, it may be well for the promoter to put up at the Astoria, the Plaza, the St. Regis, or some other of New York's expensive hotels. It will be expected. Even then, however, it is doubtful whether his negotiations would be injuriously affected in any way if the promoter disappointed these expectations by adopting a less expensive mode of living.

It is also to be noted that but little financing is

done in these days by means of wine suppers and other costly indulgences. A comfortable little dinner for a few interested parties may occasionally be very helpful in closing up a deal. But as a rule nothing more is expected or desirable, and while a high-priced hotel may be a very good means of parting the promoter from his money, it is not at all necessary to the success of his undertaking.

In all such matters, speaking generally, the people of New York are very cosmopolitan, and so long as a man dresses reasonably well, pays his bills as he goes, and does not try to negotiate small personal loans, they care but little how he lives when not in sight. They are not imposed upon or even favorably impressed by a disregard of the usual economies, nor are they unfavorably impressed or discouraged by their observance. If they wish to determine the promoter's financial status, they consult a commercial agency and do not vex themselves as to his mode of living. A good, comfortable hotel or respectable boarding house will therefore afford as advantageous and sound a basis from which to finance any ordinary deal as will the Plaza or the Astoria.

Of course, economy in this direction must not be carried too far. It is doubtful, for instance, whether any one of the numerous promoters who frequent the corridors of the Mills' hotels—where comfortable accommodations may be had at the very reasonable rate of twenty cents a night—ever financed an enterprise of importance. Their enterprises are not always bad, but the basic conditions are too unfavorable. Their economy, usually enforced, is carried to an ex-

cess which prevents business. On the other hand, it is a fact that in many cases enterprises of moderate magnitude are handicapped and seriously injured by the unnecessary and somewhat extravagant expenditures of their promoters.

In this general connection it may be said that there is very frequently an impression among people coming to New York to finance enterprises that the past history and present standing of themselves and their enterprises, save as revealed by them, are as a closed book to the parties they approach. This is not by any means the case. On the contrary, any business man, familiar with matters of the kind, will look up the standing of the parties by whom an enterprise is presented, and the status of the enterprise itself, as a mere matter of course. He may do this through some commercial agency, or through his bankers, or through private sources. However this may be, the parties presenting an enterprise may feel sure that it will be done, and thoroughly done, if the matter is of importance, and that any material information in point relating either to themselves or to their enterprise will very shortly be in the possession of the parties with whom they are negotiating. A recognition of this fact will, on occasion, save embarrassment and trouble. It will also sometimes explain delays, counter propositions, or even an emphatic refusal of a proposition, which are otherwise puzzling.

Financing in the great cities is a difficult undertaking. There is perhaps more money available in New York for good enterprises than in any other city

of the world, but on the other hand, there is perhaps no other city in the world in which good enterprises seeking money are so numerous. Worse than this is the fact that there are so many enterprises that are not good, seeking this same money. Further, men of wealth are so closely pursued, harassed and annoyed by promoters and other persistent callers with designs on their time and money, that of necessity they hedge themselves about with outer offices, railings, office boys, secretaries, personal representatives and other protective measures, until it is a matter of great difficulty to even obtain access to them. People of moderate means are, it is true, much more accessible, but even here difficulty will be found in approaching them on a favorable basis. The promoter should therefore not only pave the way in advance for access to the people he must meet, or wishes to meet, but should be so fully prepared in every way that when his opportunity does come he may avail himself of it to the utmost.

Particularly, unless the promoter has friends or good business connections in New York, should he bring letters of introduction with him, as the condition of the complete stranger attempting to finance an enterprise in New York is unhappy. For the ordinary enterprise these letters of introduction are best to men of moderate means. The financial magnates with whom some sections of New York are thronged have, it is true, money to the point of oppressiveness, but this money is not for the promoter with an ordinary enterprise, and he need waste no time in plans for its capture. Of course, if the enterprise is

one of such a character as to appeal to or require the assistance of the great financiers, the attack must be made in that direction. Otherwise they are to be avoided. Such men have so many undertakings of importance on hand and so many are constantly being offered them, that an enterprise that does not appeal to them particularly stands no show for even a preliminary consideration.

Letters of introduction then are, as a rule, best to men of moderate wealth. If the promoter can meet these men on a social footing—at their homes, their clubs, their country houses, at Belmar, Tuxedo or Lakewood—it is very advantageous, giving him a chance to approach them in an informal and effective way that would hardly be possible in an office interview.

Also, if these parties are encountered on a social footing, other introductions follow as a matter of course, enlarging the promoter's acquaintance and placing him in a better position for his work. It then becomes merely a matter of business judgment and ability as to when and how the enterprise to be financed is best introduced and presented.

A good letter of introduction serves as a basis of confidence. If the party to whom the introduction is addressed cannot or does not care about taking up the proposed enterprise himself, he will usually introduce or secure an introduction to some other party who may be interested, or will suggest some plan or way in which the necessary finance may be secured. The promoter is not looked upon as a stranger, but as a friend to be helped as may be possible. He has a firm footing from which to conduct his operations. He is practically financing among friends.

CHAPTER XXXI.

PRIVATE PRESENTATION.

Among Strangers—(Continued)

When the promoter endeavoring to finance an enterprise comes to New York as a stranger or with perhaps but a few unimportant business connections, or when he comes with letters of introduction that avail him nothing, his condition is a hard one. There are then several courses open to him of varying degrees of difficulty and discouragement. He may advertise for capital, he may respond to the advertisements of those who offer to supply capital, he may endeavor, without the formality of introduction, to reach the parties to whom his enterprise should appeal, or he may endeavor to reach parties who will take up his enterprise and, acting as promoters, finance it for him.

Casual advertising is hardly worth the trying. An extensive campaign of publicity, involving large expense and the skill of experience, is necessary for successful financing by advertising. For the ordinary enterprise such a campaign is impracticable. Any other plan of advertising for capital will not ordinarily produce sufficient results to even pay its first cost. The writer must admit that he has known some few

cases where very considerable amounts have been raised by small casual advertisements of but six or eight lines inserted in the business opportunities columns of the New York papers. As a rule, however, such advertising is absolutely fruitless, the success mentioned resulting from such a combination of an attractive enterprise, accidentally attractive advertising and good luck—the greatest of these being good luck—that it establishes no precedent and the whole matter may be dismissed from consideration.

It may be noted in passing that any such advertising will usually bring in responses—not from parties who have capital to invest, but from parties who are willing and even anxious to try to find capital for the advertiser. Frequently they will offer to advertise for him, at his cost; at all times they will have some scheme to get money from him. Time, trouble and expense will be saved if such parties are let severely alone.

Appeals to the numerous houses which advertise to secure capital are, speaking generally, even more hopeless. There are many of these houses, but the usual result of an application to them is the same. Their first consideration of the matter is almost invariably favorable, no matter what the enterprise may be, but is with equal invariability followed by a demand for money. This demand is made on such pretext as will meet the conditions. If the enterprise is not incorporated, a fee and expense money for its immediate incorporation will be demanded. If the enterprise is already incorporated, a re-incorporation may be announced as essential, or if these demands are not

tenable, money will perhaps be required to get out an issue of bonds, or to take out foreign patents, or to arrange a guarantee of stock or bonds, or possibly to have a prospectus printed, or it may be to advertise stock for sale, or sometimes—and possibly the most honest demand of all—money will be requested as a retainer.

It is but rarely that anything follows the payment of money on any of these pretexts, unless perhaps the “house” undertaking the financing of the stranger’s enterprise can think of some further plausible scheme for the extraction of money. It is a case where the stranger and his money are parted with the greatest possible expedition, and thereafter the only anxiety of the “financing house” is to be safely parted from the stranger. Speaking generally, a stranger in New York can safely and profitably terminate his connection with any promoter or promoting house—either prior to or subsequent to the time such connection is formed—just as soon as any advance payment of money is demanded, no matter what the basis of the demand. Theoretically a concern undertaking the promotion of an enterprise is entitled to a retaining fee or payment for services to be rendered; practically, in New York City at least, reputable houses taking up enterprises do not demand anything of the kind, and this is so true that a preliminary demand for money is generally regarded as unmistakably classifying the concern. The whole subject will be found more fully treated in a subsequent chapter (Chapter XXXVIII) under the title of “Promoters” and “Financiers.”

If the stranger undertakes to reach parties to whom his enterprise should more especially appeal, without the formality of an introduction, the outlook is not of the best, but is not hopeless. Such things have been done with much success and will be done again.

When this course is attempted the first appeal may be made either by letter or by a direct call. For instance, a party with a valuable bed of marl may wish to bring it to the attention of some good cement company or of some individual interested in cement. He can get the addresses of the companies and also their list of officers from the directories. Then he may either write to these parties or may call and gain access to them if he can. If he decides to write, his letter had better be addressed in each case to one of the company officials. A letter bearing merely the company's address might not get into the right hands and therefore fail, but any official receiving such a letter would, if the matter were really of interest, see that the letter reached the proper person. In the absence of any information, one of the higher officials might be selected at random, though an enquiry at the company's office would probably elicit the name of the official best addressed. Then a brief, concise, strong letter should be written, stating exactly what the owner of the marl bed has and what he wants to do with it.

Such a letter should be as short as it can be made and still contain sufficient information to enable the recipient to determine whether the matter is really of importance. A full presentation should not be attempted. In the case under consideration, the letter

should give the extent and depth of the marl bed, the quality of the material, if possible, and any tests or actual uses to which it has already been submitted. The general condition of the bed—by what title it is held, shipping facilities, convenience of location, etc., etc.—together with any peculiar advantages it possesses should also be briefly set forth. Finally it should be stated whether the bed is for sale or lease, or is to be handled in some other way, and some general idea of the terms should be given. A sample of the marl might also be sent. If the party really has something of value, a good business-like letter of the kind will usually elicit a response, and a courteous response, even if it be only to turn the proposition down.

If the party addressed is interested by the letter, he may write for further details, but will usually invite the writer to call. Then the matter takes on a favorable aspect. The party calling should be prepared to identify himself—best by his letter of invitation—and should bring some evidence that he is a responsible party or is really empowered to act in the matter. He should also be ready to substantiate the statements of his letter and to furnish any other pertinent details that may be required. The whole matter is then one of a strong presentation, and is likely to lead to business. Even if it does not, the opening so created may result in other introductions or suggestions that will be of advantage.

If the owner of an enterprise prefers to make a personal visit to the parties he wishes to interest, without paving the way by a preliminary letter, he

must equip himself with personal or business cards, considerable assurance and a determination not to be discouraged by refusals. In most New York offices he will be given pause just beyond the threshold of the outer office by a stout railing, behind which is an office boy in control of the situation. The boy alone will usually "man" these outer defenses. The stranger's name will be requested as also the nature of his business. He will also be asked if he has an appointment, or is a friend of the party upon whom he is calling, or be requested to explain the basis upon which the visit is made. Possibly the caller's card will be retained, but will not be taken in at the time, the refusal being tempered by the terse explanation that the parties called upon are busy. In such case the only course is for the visitor to withdraw and call again, either at some time suggested as likely or convenient by the office boy, or at such time as he may deem convenient for himself.

If the visitor's card is taken in, the party called upon may very probably decline in toto to see his visitor. If the business is something likely to appeal to him—as, for instance, the marl bed presented to a cement man—he may invite the stranger to call again at some indefinite time when he is not busy, which is a very unsatisfactory arrangement, or may make an appointment, or may, if not busy with other people at the time, invite the caller right in and discuss the matter with him briefly then and there. Usually, however, if he takes the matter up at all he will make a definite appointment. If he takes the matter up at the time it will usually be a very brief

discussion, and will be followed by an appointment for a more extended interview if the matter seems to justify further investigation.

The reception accorded the unintroduced visitor will vary with the custom of the particular establishment. In some few New York offices he will find the same breezy informality of access that characterizes the office life of a western mining town, and will be able to walk unannounced and without delay into the inner office and the presence of the "chief executive." In others, and particularly when one of the men of great and known wealth is sought, he will find the lines much more closely drawn. The office boy will be replaced by a stately major domo who will investigate the visitor's past history and present business with care before moving in the matter at all. If this first examination is successfully passed, the caller is referred to a higher official who, after due delay and proper appointment, conducts a more searching examination of the applicant and his enterprise. If impressed favorably, the applicant will be passed on perhaps to the private secretary of the man he wishes to see, who will again make an investigation of the presentation and the presenter. If this investigation is again satisfactory and the private secretary deems the matter too important for him to settle and one that his employer might be personally interested in, the man with the enterprise will at last reach the inner fortress and meet the magnate, upon whom rests the fate of the presentation. Usually, however, he will be referred to the head of some department, or other official to whom the matter properly belongs, and will never see the head of the office at all.

It must be borne in mind that in any case of this kind, the unusual and informal method of presenting the enterprise handicaps it heavily at the start. The party called upon is justly suspicious, and if not disposed to dismiss the matter without consideration, will look upon it askance. He properly expects anything of the kind to come through the regular channels.

It is also true that very occasionally the officials of a concern or institution will refuse peremptorily to receive a really desirable proposition in this unheralded manner, for the very simple but sufficient reason that a direct presentation affords no opportunity for the "rake-off" or tribute which they are accustomed to levy on all transactions of the kind. Naturally such a reason for refusing a proposition would not be stated in words, but must be read between the lines.

In any such case, if the applicant wishes to persevere in this direction, he must discover the proper channel of approach. Perhaps one of the officials will suggest a party who might take the matter up. Possibly the office boy or some clerk or stenographer may give a clue. In any event, if the proper party is discovered, he will be quite willing to take the enterprise up and present it to friends who he thinks will be interested. This party must, of course, receive a commission for his services. The friends may be interested when the matter is presented to them and wish to present it to other parties, and for this presentation they must also receive a payment or commission. Sometimes in a case of the kind the enter-

prise will pass through half a dozen hands before reaching its final destination, and the accumulated commissions will be quite a heavy burden, though dependent of course upon the enterprise being finally financed.

Under such conditions the official who finally passes upon the enterprise does not nominally receive any profit from the transaction. As a matter of fact he receives his proportion of the commissions paid the parties through whom he is reached. In justice to the officials of New York institutions it must be said that such conditions, though they will occasionally be encountered, are uncommon.

It must be remembered in any attempt at an "un-introduced" presentation that the business men of New York have but little time to devote to irresponsible strangers, and that the visitor is looked upon as belonging to this unprivileged class until he has proved the contrary. For these reasons if he is admitted he should be prepared to make a very incisive, clear statement as to himself and his property. If he can once convince the parties called upon that the proposition is one they should be interested in, and that he can "deliver the goods," the visitor is likely to be received then and thereafter with all due consideration. The whole matter then becomes merely one of a good strong presentation, very concise and pointed at first, to be followed by such extended explanations and statements later as the negotiations may require.

To finance a good enterprise by the method outlined is difficult, but not at all impossible. Success-

ful men of business are in most cases successful because they are keenly alive to anything that may affect their interests and, speaking generally, they are not going to turn down an otherwise attractive proposition because it is presented informally. If, then, they can once be convinced that there are merits and possibilities for them in any particular enterprise, the battle is more than half won, and the conditions are usually as favorable, and sometimes even more so, than if the "approach" had been made in the customary formal manner.

It is to be noted, however, that an entrance of this kind places the parties on either side in what may be termed a condition of armed neutrality. The business man is suspicious of the visitor who has dispensed with the usual formalities. He rather expects and is on the lookout for trickery. On the other hand, it behooves the visitor also to be wary. He has waived the rules of the game, and if the business man sees something attractive, it is quite possible that he will not respect the property rights of his informal visitor as far as might be desirable, or as would be the case if this latter were properly introduced. Against this the visitor can only protect himself by the exercise of watchfulness, trading ability, and, if the matter is to be consummated, by the employment of a good lawyer.

In any such presentation the fact must not be lost sight of that it involves an intrusion—usually more or less unwelcome—upon the busy hours of a busy man. It is therefore the part of wisdom to make the first presentation as brief as justice to the proposition will permit, and, should the matter not prove inter-

esting, to retire at once as soon as this is definitely ascertained. The methods of a book agent or life insurance solicitor cannot be followed too far in the presentation of an enterprise.

If none of these methods suggested for the promotion of his enterprise appeal to the stranger in New York City, there is but one other usual course open to him. This is to reach individuals or firms who will take up his enterprise, and, acting as his promoters, finance it for him.

This is a very different proposition from responding to the advertisements of those who professedly make it their business to finance enterprises. The men to be reached—that is, the men who actually can do something for the enterprise—do not often pose as promoters, nor do they advertise. They are not in hiding, but neither are they proclaiming themselves on the housetops. They are in businesses of their own, and usually good businesses, and they do not go out of their way to secure enterprises to finance. They must be looked for and discovered, and the quest is difficult.

Promoters of this kind are not scarce; in fact, there is hardly a business man in New York but who, if an enterprise appeals to him and is within his ability, will undertake its financing. To find the particular man to whom the enterprise in hand will appeal is, however, difficult. Another, and almost as great a difficulty, lies in the avoidance of the self-alleged promoters who infest the financial district of New York and who, having neither ability, connection nor standing to enable them to finance an enter-

prise, are nevertheless cheerfully willing to undertake to do so on any and all occasions.

These pseudo-promoters are numerous. In many cases they are professionals, making their living out of the industry. In other cases they are nominally engaged in business for themselves, taking up promoting as a side line. In still other cases they are merely "connecting links"—men who do not profess to promote directly, but who know men who can promote. All of these are usually men of pronounced views as to their own abilities as financiers.

These promoters are always on the lookout for "deals" and when an unwary stranger comes their way with an enterprise they are very positive that they are the men he is looking for, and will with the most cheerful optimism undertake to finance his enterprise, regardless of its condition or nature, on almost any basis the stranger may desire. They are very anxious to undertake the work, rarely demand money in advance because they realize the hopelessness of the proceeding, talk glibly and irresponsibly of their connections and past performances, are entirely confident of their present ability, and to the unacclimated stranger with an enterprise, who is not acquainted with the tribe, appear as the shadow of a great rock in a weary land. It is but seldom that they are of any more substantial benefit.

If the unwary stranger allows himself to be entrapped into an entangling contract with one of these promoters, the latter will usually make an effort to finance the enterprise. He has no conscientious scruples against financing it if he can. Usually, however,

he cannot, and the matter drags along until the owner of the enterprise becomes tired of the delay and determines to take his enterprise to other parties. Probably he then finds that his enterprise has been discredited and injured by the unfortunate alliance. Almost always he will find himself tied up very securely with his "non-promoting" promoter.

Either the promoter will have provided for the exclusive control of the enterprise for a certain or uncertain length of time, or he will have a contract for a certain payment or perhaps a proportion of the stock or other securities of the enterprise in compensation for his efforts in the matter, or perhaps he has both, and then when the owner wishes to present the enterprise elsewhere, refuses to release his control except for a substantial consideration, or demands his contract payment for the efforts he has made in the matter. Of course the contract should be worded on the "no cure no pay" plan to prevent all this, but frequently it is not, and the promoter then takes every advantage of the conditions. It is a fact that many a good enterprise has been seriously crippled by the old man of the sea attitude of its alleged promoters.

This whole subject is treated of in a subsequent chapter (Chapter XXXVIII), but it may be said in passing that parties placing enterprises in the hands of others for promotion should take every precaution to guard against contracts for exclusive control, for percentages, commissions, payments or other claims of any such nature as will later prove embarrassing or perhaps absolutely prevent them from financing their propositions elsewhere.

As a rule reliable promoters are only to be found by indirect means. Sometimes, but rarely, they are found by advertising. Such men do not, as a rule, read the "business opportunities" columns in which such advertisements would usually appear. A good card in the financial columns of the better papers of New York may sometimes be seen by them. Usually, however, they must be found by personal effort. Perhaps a friend or acquaintance will direct the man with an enterprise to the party who can promote it for him, or perhaps the owner and the promoter will be brought together in other business matters, or perhaps the party with the enterprise will decide from his general knowledge of it and of the situation who ought to be able to promote the enterprise and get introductions to the selected parties.

These reliable promoters are not confined to any one class of business. Bankers occupy an enviable position for financing. Some few—as the firm of J. P. Morgan & Co.—make a specialty of high class promoting. As a rule, however, bankers will not appear openly in ordinary promotion work for fear of injuring their standing as safe and ultra-conservative business men. Brokers, whether stock, bond or investment, also occupy an excellent position for promoting, and not being troubled with the scruples that keep bankers out of the field, frequently undertake the financing of enterprises. When they do, they usually make first-class promoters.

Here the problem is to find the proper broker. There are probably more than a thousand brokers in New York City alone engaged in dealing in securities

and investments of one kind or another. Most of them are responsible and reliable. Not a few of them are much the reverse. They are of all shades of business reputation and calling within the limits of the craft. Some of them will "promote" on occasion and some will not. To find, then, the individual or the concern to which a particular enterprise will appeal, if it appeals to any, is frequently a matter of great difficulty.

If an enterprise is distinctly in the line of one class of brokers, that class will naturally be appealed to. That is, if a railroad is to be financed, it would—if brokers are under consideration—naturally be taken to a house dealing in railroad securities, or a mining proposition will go to a concern which makes a specialty of mines or mining stocks, or an industrial proposition to firms dealing in stocks of that nature.

Doctors also on occasion make good promoters, particularly for enterprises that come within their province. Ministers occasionally do surprising feats of promoting, but generally and properly will have nothing to do with the work. The legal profession provides a large number of first-class promoters. Lawyers are necessarily and intimately acquainted with the affairs of their clients. They are usually pretty good business men themselves. They are always open to an opportunity to make money, and if a good enterprise comes their way that appeals to them or may appeal to any of their clients, they are not likely to let it pass by. In fact, at times lawyers are instructed by their clients to watch for suitable enterprises.

This is particularly true in the case of patent law-

yers, though no member of the guild would openly admit the fact. More incipient enterprises pass through the hands of patent attorneys than through the hands of any other class of men, and, trained as they are to see the good and bad points of inventions and familiar with the industrial field, they are in a peculiarly favorable position for promotion. Usually they are on the watch-out for inventions which are particularly desirable. Even when the patent attorney will not act directly in the matter, he will frequently be able to direct the owner of a patent to the proper sources to obtain the money he needs, particularly if his invention is a good one appealing to special industries.

In the field of invention houses exist which make a specialty of selling patents. The announcements of these patent selling concerns appear in most of the publications relating to patents and inventions. Some of these concerns are reliable. Others are very far from it, and difficulty will be found at times in separating the wheat from the chaff. In dealing with them the general rule should be observed that any request for advance payments, or indeed payments on any pretext until the patent is sold, is *prima facie* evidence that the concern had better be left alone. In all cases when a patent is placed in the hands of one of these houses for sale, it should be under such a clean-cut contract as will not tie the patent up unduly and will protect its owner.

If someone is discovered who is suitable and is willing and apparently able to undertake the financing of an enterprise—in other words, an apparently satis-

factory promoter—the question of a contract will arise. It is entirely proper that a contract should be given. In fact, a reliable promoter would not undertake the financing without, but before such a contract is entered into the owner of the enterprise should investigate very carefully and satisfy himself as to the standing and ability of his promoter. As a rule, a man to be successful in promotion must be a man of property, or of good business standing and reputation, or a man of good connections with whom he stands well. A commercial agency report is the simplest way of deciding whether the particular promoter possesses some or all of these requisites. If the agency report is not available, or is not conclusive, enquiry must be made among friends, or the business connections of the promoter, or perhaps through the banks. The matter is not a difficult one if the man's standing is really good. If it is not good, it is sometimes difficult to establish this fact satisfactorily.

Usually before settling upon terms, the owner and the promoter will discuss the whole matter, decide upon the general line of financing—in which the promoter should be able to advise to much advantage—and then come to the compensation of the promoter. The subject of terms between the owner and the promoter is discussed in Chapter XXXIX, "Commissions and Bonuses," and need not be considered here.

It may be stated generally, however, that the promoter expects and receives in case of success, a very liberal remuneration. This may be a fixed cash payment, or a percentage of the money secured; or if the subject matter be an invention, a royalty may be

demand; or if it be a sale, a commission on the price will usually be asked. Or perhaps the inventor may fix some flat price for himself and allow the promoter to add thereto some reasonable or unreasonable amount as his commission, agreeing to protect the promoter in the advanced price. This arrangement is not uncommon and is discussed at some length in Chapter XXIII, "Excessive Capitalizations."

Very commonly the promoter's compensation will be an interest in the financed enterprise—that is, either he will have an allotment out of the stock or other securities reserved for the owner, or he will reserve for himself a certain proportion of the stock or securities to be sold, or he will merely undertake to put a fixed sum of money into the treasury of the company in consideration of a certain amount of stock being turned over to him. In this latter case he will save for himself as much of the stock as he may be able.

The contract with the promoter should be clear on all the important points and be formally drawn. The promoter will not undertake positively to secure the needed finance. It is obvious that he could not do so under the conditions usually prevailing. All he can safely undertake is to endeavor to secure the needed money, or to interest suitable parties. The agreement with him then should specify that his payment is only to be earned and only to become a claim upon the enterprise in case he is successful in his attempt. It is very important that this should be clearly understood and as clearly stated in the contract.

Equally important, if any exclusive control of the enterprise is given, is a provision fixing some date on

which this control will terminate, unless the promoter has financed the enterprise meanwhile or has made progress thereto satisfactory to the owner. Then, at the conclusion of that period, the owner is free and may put the enterprise in the hands of others if he desires, the only claim of the original promoter being for results actually secured in accordance with the terms of the contract.

When the owner of an enterprise has secured the services of a good promoter and has entered into a contract with this latter, his own duties are light. He places the whole matter in the promoter's hands, giving him all essential facts with such material in the way of supporting documents, statements, reports, samples, etc., etc., as may be necessary and he be able to secure. The promoter then practically does the rest. He may call on the owner for demonstration work or expert assistance, if the owner is qualified, but will prepare his own prospectus, arrange for the incorporation of the enterprise—if so agreed—lay out his own campaign, and carry it to a probably successful conclusion.

CHAPTER XXXII.

PUBLIC PRESENTATION.

By Circular Letters.

The usual methods employed in the public presentation of an enterprise involve too great an expenditure and too elaborate a campaign for any ordinary financing.

A modification of these usual methods is, however, sometimes employed, which, not requiring such extensive and costly exploitation, can be more generally used. This is the direct appeal to selected parties by means of circular letters or other printed matter. The only necessary expenditures are for the preparation and distribution of this printed matter.

The method of direct appeal partakes much of the nature of a private presentation. Unless conducted on a large scale, it is far less expensive, is quieter, more easily managed and perhaps more dignified than is the usual public presentation, and has many desirable features. It is frequently adopted, with or without general advertising to support it, in the financing of those sound and conservative enterprises which must of necessity make a more or less public appeal, such as banks, surety and trust companies, building associations and other large and semi-public under-

takings. These lack the popular features usually requisite for a successful public presentation, but substitute for these a safety, a solidity and a well-known operation and management that appeals to the conservative investor far more powerfully.

Circularizing is also at times, and especially of late, employed in financing the ordinary industrial enterprise. Such enterprises, however, as a rule lack the popular features necessary for success in a popular presentation, and have no effective substitute. They must therefore usually depend upon private presentations for their funds, leaving the public presentation, whether by circular letter or general advertising, almost entirely to the speculative enterprise.

The *modus operandi* of a presentation by circular letter is simple. The letter is the principal feature and is prepared so as to present the enterprise as strongly and as attractively as possible. This letter will vary in length according to its scope—the shorter the better, so long as the proposition is properly covered. It may or may not be accompanied by a prospectus. If it is, the letter may be made very short. It is in fact sometimes dropped entirely, the prospectus being used alone. The letter, however, gives a personal element to the presentation that is very desirable and as a rule it is used. The advantage of employing both letter and prospectus lies in the fact that as the main features of the undertaking are presented in the prospectus, the letter may be made much more concise and to the point than would otherwise be the case.

This circular letter with its accompanying prospectus—if a prospectus is used—is mailed or otherwise

delivered to such selected parties as are, or should be, or may be interested in the undertaking. As a rule when a communication of this kind is received it will be examined with some care, particularly if attractive in matter and manner. It is but rarely that a business man throws any communication into his waste basket without getting some idea of its contents, and in almost every case no matter how busy the recipient may be, the letter will be read in whole or in part. It is then the function of this letter to present the important features of the enterprise or the proposition with such strength and attractiveness that the interest of the reader will be aroused—so much so that either then or later he will read the fuller presentation of the prospectus, or take such further action in the matter as may be desired by the promoters.

The circular letter is usually an ordinary fac-simile typewritten letter, the name of the party addressed being inserted in a style similar to that of the body of the letter, so as to convey the idea that the letter is in fact a personal and particular communication to the party addressed. Such letters are usually sealed and sent under letter postage to carry out the illusion. It is but rarely that these letters deceive, but as they cost but little more than an ordinary printed letter and undoubtedly do have some element of personal appeal, their employment is justified. The use of the two-cent stamp and the sealed envelope is usually desirable for the same reason. Occasionally when exceptionally good names have been secured, actual personal letters—all of course after the same model—will be written out on the typewriter and be signed

by the parties in charge of the presentation. The cost of these real letters is not at all excessive if prepared under proper conditions, but they involve additional trouble and are, as a rule, used only in special cases. It is probable that they could be used more freely to much advantage. The general subject of "form" letters is discussed further in Chapter XXXIV of the present volume.

As to the effectiveness of these fac-simile letters as compared with printed letters or circulars, we quote from the prospectus of a concern making a specialty of furnishing lists of names for circularizing: "The question, 'Are not just as good results obtained by mailing investors a printed circular as by an imitation typewritten letter?' is frequently asked. Our answer, backed by actual tests, is most emphatically no. Because it is an undeniable fact that every man and woman, however high or low may be their station in life, are more susceptible to an appeal when made to them individually through personal letters than they are to one made to the world at large. Therefore, as the results you will receive from circularizing will largely depend upon the kind of letter mailed, it will certainly pay you to see that every letter is as nearly as possible an exact imitation of a typewritten letter. The party's name, address, date and salutation must be perfectly matched in at the beginning of the letter so that it appears that the entire letter was written on the typewriter."

The letter, as already stated, should, when accompanying a prospectus, be brief, attractive and to the point. It must seize upon and hold the attention of

the reader and excite his interest to the point of subscription if possible, but certainly to such a pitch that if the matter appeals to him at all, he will look into the details of the proposition. The letter will usually contain a résumé or statement of the striking features of the particular enterprise, or of specially attractive features connected with it, include perhaps a few pertinent facts as to the standing and ability of the parties in charge, explain the wonderful liberality of the proposition and give reasons why the entire financial future of the reader depends upon the acceptance of this proposition.

If a prospectus does not accompany the letter, this latter will of necessity be more lengthy and go into detail more fully than would otherwise be the case, as it must then combine in itself both letter and prospectus and make a brief but complete presentation of the whole enterprise.

The subject matter of the prospectus when it is used in connection with the circular letter, will be much the same as for any other presentation. It must, however, be borne in mind that no personal work is usually possible to reinforce this printed matter, and that it alone is relied upon for results. The printed matter must then be of a high order.

The letter, or letter and prospectus, or prospectus, is sent out to such selected names and in such numbers as the promoter thinks desirable. He then awaits returns from the seed he has sown. These returns range widely from nothing at all to most gratifying amounts, varying with the skill with which the printed matter has been prepared, with the judgment shown

in the selection of names and with the number of letters sent out. Unless the names are good, the printed matter excellent, the enterprise itself attractive and the number of letters sufficient, the returns are apt to be distressingly small.

The possibilities of this kind of work are large. In other words, there are multitudes of small investors with money for investment if they can be reached. The following matter comes from the prospectus already mentioned: "In the State of New York alone the savings banks have on deposit over one billion dollars. This vast amount of money is only earning from three to four per cent. Within a radius of one hundred miles of that city there are thousands of clerks, mechanics, and professional men and women earning large salaries and having no business of their own in which to invest their surplus funds. All these must seek channels for investment. Every state of the Union is prosperous. There is plenty of practically idle money waiting for all classes of investment."

The statements of this quotation are in the main correct. There undoubtedly is a very large class of people who have money for small investments and for whom it is almost impossible to find desirable investments. If they can be reached and reached properly, the response will be satisfactory.

By way of direct application our prospectus adds: "You can get a portion of this money if you go after it in the right way and present your proposition to the right people. It is said there are about seven millions of stockholders in mining, oil and the cheaper industrial companies, located throughout the eastern

states. Don't you think it will be profitable for you to get your investments before at least a portion of these investors? The quickest and most economical way to do it is by circularizing lists known to be composed of such investors."

The conservatism of the suggestion that only a portion of the seven million stockholders be circularized is to be commended. The conclusion as to the superiority of circularizing "stock lists" over any other method of reaching the investor can hardly be accepted in toto. These lists are used by many different enterprises seeking money and new "unworked" names, which are highly desirable at times, are not to be secured in this way.

Comparing the advantages of circularizing over the employment of brokers, as a means of getting money, the prospectus already quoted says: "'From the producer to the consumer' is always a drawing card. It makes no difference what kind of a proposition you have; by securing lists composed of investors suitable for it, you can interest as much capital as the so-called brokers. How many of these so-called brokers have any actual buyers or capital furnishers? When you pay them from two hundred dollars to one thousand dollars as a retainer or to show your good faith, ostensibly to be expended for printing and postage stamps, while in reality perhaps ten dollars is so spent and the balance pocketed by the brokers, what recourse have you? Spend your own money. Do your own mailing and you will see that the stamps and literature you pay for are used. By using but a small proportion of the money you would otherwise pay for a broker's

expenses, in preparing an attractive prospectus and mailing the same yourself to lists of actual investors, which we can supply you with, we know you will get satisfactory results."

This requires but little comment. Its general reasoning and statements seem to be entirely sound. The apparent rashness of the claim that capital can be secured for any kind of proposition by this method is saved in the concluding phrase, "you can interest as much capital as the so-called brokers," as these latter are somewhat notorious for their failures in the way of securing capital for clients. The iniquities of the concerns advertising to secure capital for enterprises are referred to at some length in a later chapter of the present volume.

As to the general advantages of circularizing as a means of raising money, our prospectus says: "A personal letter, accompanied by the right kind of literature (not expensive), will always be opened and read, and if it is sent to the proper party business is sure to result. Another and very important reason for adopting 'The direct appeal through personal letter' system in preference to others is, that in addition to its being so effective, it is also the most economical of them all. By selecting the most suitable lists for the proposition offered, there will positively be no waste in circularizing, as every name on them is of an individual you want to reach. It is an easy matter to reach the investor by mail, provided you start right, and it always pays. The necessary equipment for mail order work is: (1) Up-to-date lists composed of investors known to be interested in and who favor

your particular class of investment. (2) The best known process of a fac-simile letter with the name and address perfectly matched at the top and accompanied by a well written and attractive prospectus. (3) About fifteen days after first letter, a second and then a third follow-up letter should be mailed to those not replying to first communication. We know of some companies who go over each list not less than six times, and it pays every time. A careful record of those answering the first communication should be made by checking their names on the list. Many brokers and companies have made the mistake of circularizing the list but once, and for a lack of confidence or for the necessary money to buy stamps throw it aside and 'knock' circularizing. The best results are usually secured from the second and third communications."

The statements quoted are much to the point, are reasonably accurate, and their suggestions are in the main good. It must, however, be borne in mind that the prospectus quoted from has for its direct purpose the sale of names to those who wish to adopt the method of financing discussed, and its recommendations must therefore be received with some reservations. Its optimism as to the ease and certainty of getting money by the method suggested is also to be liberally discounted.

The names employed for circularizing should be selected with much care. Every poor name represents a distinct loss of money, time and effort. In a very small presentation the list might merely include names personally known to the promoter. Ordinarily, how-

ever, circularizing is conducted on a much larger scale. A very restricted presentation will send some hundreds of circular letters and the usual modest presentation of the kind would send out as many thousands. From this, the number runs up into the hundreds of thousands and even millions of circulars sent out in financing the larger undertakings.

In any of these cases lists of names may be obtained from various sources. The classified business directories are sometimes used in making up lists when the enterprise appeals to a particular class, or the reference books of the commercial agencies when the standing of the parties is of importance. As a rule, however, the names for circularizing purposes are purchased. Concerns exist—such as that originating the quotations of the present chapter—which make a specialty of selling classified lists of names. The advertisements of these concerns may be found in the financial papers, and the majority of their lists are fairly reliable. Another source from which names are commonly obtained is found in the addressing agencies of the larger cities. These agencies make a business of addressing envelops, wrappers, etc., etc., and almost invariably possess lists of names which they use themselves and which they are always willing to sell to outside parties. The prices of these lists vary greatly according to the character of the names and the standing of the concern which sells them. The price will ordinarily range from two to three dollars a thousand upward, according to quantity and quality.

Occasionally excellent lists of names are obtainable which have been secured in the financing of some

other enterprise by general advertising. The lists of stockholders of existing enterprises of a similar character also afford exceptionally good material for this kind of work. Some special enterprises appealing to particular classes, as bankers, lawyers, doctors, etc., will find directories covering the entire United States already prepared for their use.

The statements of the preceding quotation as to follow-up letters must be received with some caution. Actual experience in circular work does not fully bear out its claims. These follow-up letters are merely letters sent out to the parties to whom circular letters have already been sent but from whom no response has been received. These later letters are intended to reinforce the appeal of the first and, if possible, to bring the recipients into the fold. In some cases a cumulative effect is undoubtedly produced by one letter coming after another, but as a rule the best results will be secured from the first circularizing. From the second lot a smaller percentage of responses will be received; from the third mailing a still lower percentage, and so on.

Here comes in one great advantage of circularizing as a means of financing. No great risks need be taken at any time. The first attempts in all directions may be experimental. The first lot of circulars may be few in number—though they must always be sufficient to give a real test of the presentation—and the parties in charge will be governed by the results. If the returns are small or inadequate, either the proposition is not suitable, the presentation is not sufficiently attractive, or the names are not good. If suspicion is

directed to the presentation, more attractive letters may be gotten up and mailed again either to the same list or to new names. If the lists of names are of doubtful quality, new lists may be tried, and this experimental method—this feeling of the way—may be continued with comparatively small expenditure until the success or the failure of the method for that particular enterprise has been demonstrated.

So also with the follow-up letters. These letters may be tried with a limited number of the names already circularized. If the results are good, the process will naturally be continued. If the results are not good, it may be discontinued without serious loss having been incurred. The subject of follow-up letters is more fully discussed in Chapter XXXIV, "Newspaper and Magazine Advertising."

In any experimental work of this kind it should be borne in mind that the effort must be on a sufficient scale to really prove the success or failure of the plan. A few circulars would be no test of a presentation. A few hundred might not be a conclusive proof, though this number should in an ordinary presentation bring some result and be sufficient to show whether the right lines are being followed and whether the effort should be extended along these lines. A few thousand circulars would, however, usually be a more satisfactory test and be necessary to really establish the merits or defects of any special features of the presentation.

As to how the prospective stockholders should be treated, the prospectus quoted from says: "Let the prospective investor have the opportunity of investing in your securities at 'Ground Floor Prices.' Do not

ask Par for the securities of a corporation just beginning. Start a limited number of your shares at a fair price and THROUGH CIRCULARIZING create a market for them. You can then offer the next allotment at an advanced price. If you treat investors fair, assuring them of a 'Square Deal' for their money, they will furnish your Company with all the capital it requires. Stockholders should be considered and treated as partners. They should be furnished at stated periods with detailed reports of the progress being made and the future prospects of the Company, as they like to know, and are entitled to the information as to what is being done with their money."

This statement is unduly optimistic as to the ease with which capital will be secured and the simplicity of the general proceeding, but is eminently just as to the treatment to be accorded prospective investors and stockholders.

The classification of investors by this prospectus is interesting and to the point. They are divided into three classes. The first or conservative investor, the man who buys gilt-edged securities only, is passed over lightly as unpromising material for circular work. The third class, composed of those who dabble in "Wall Street securities," is also dismissed under the general characterization of gamblers "wedded to the Street." The second class, composed of the great army of small investors is, with justice, more highly considered, and is treated of at some length as follows: "Under this class is a vast army of small investors located all over the country who have a burning desire for large profits and quick returns upon a small

investment. 'An income for life on a small investment' reads the advertisement. '\$1,200 a year for life,' or '\$100 invested five years ago is now worth \$5,000' reads another. These are the kind of investments they are looking for. This class of investors will buy anything that is offered to them if offered in the right way. What the merits of your proposition are amounts to little. It's what you say about it and how you say it that counts. While this class of investors must necessarily be classed as the 'small investor,' it is wrong to think that their investments are limited to a ten-dollar bill. We have found among mining and oil stockholders lists the names of many men occupying prominent positions where their investments ran into hundreds of dollars. The people composing this class of investors are usually found, however, among clerks, mechanics, small store-keepers and professional men and women having a desire to better their condition by investing the few hundred dollars of their surplus funds where it will produce the largest and quickest returns. If you had the name of every stockholder in every mining, oil or cheap industrial company in this country, you would find ninety per cent. of them to be investors of the above class. * * *

"This class of investors are by far the easiest to interest through the mails. They are the most susceptible to the 'Direct Appeal,' through well written 'Personal Letters.' It is this army of small investors who are easily interested and will invest in the stock of mining, oil and the cheaper industrial enterprises because they offer the largest and quickest profits."

This is a very bald statement of the conditions, but in the main is undoubtedly correct. The ethics of its suggestions need no discussion here. As to lists of names it must be borne in mind that those usually furnished by the addressing agencies and other similar concerns as well as those taken from the reference books of the commercial agencies are what might be termed "stock names"; that is, names which are furnished, or are accessible to all who desire them. Probably all of them have been recipients of circular letters or prospectuses from numbers of the enterprises then on the market. This being true, substantial results will require a presentation at least as attractive in some way, either as to the enterprise, as to the printed matter or as to the proposition, as those which have gone before, or perhaps the presentation may succeed without equal or superior attractiveness merely because it is timely.

In conclusion it may be said that while there are undoubtedly merits in circularizing as a method of financing enterprises, its expenses are not inconsiderable and some business skill and ability are usually requisite to success. Literature—and literature of good quality—must be provided, good names must be secured, the printed material must be properly prepared for mailing, and postage must be paid. Further, much correspondence is usually involved and the incidental expenses are apt to mount up rapidly unless carefully watched.

Also, should the presentation be poor, failure is inevitable. Or should the list of names secured be unsuitable, or "worn out" before it comes into the

hands of the party circularizing, the results will be meagre even if the enterprise and printed matter are of the best. Sometimes, also, when every condition seems favorable, an effort will fail in a way that cannot be explained.

Before the method is adopted in any case it would be prudent for the interested parties to investigate with some fullness just what is being done in this line by others. As the circularizing method is of the "still hunt" variety, it may be difficult to secure matter sent out under this plan. The printed matter sent out in the usual public presentation is, however, as a rule, equally suitable for circular work, and as such printed matter is largely advertised in any financial or investment paper, samples—and very excellent samples—are not difficult to secure. A careful study of these specimens will give a clearer knowledge of what is to be done and the best way of doing it, than anything else short of actual experience.

CHAPTER XXXIII.

PUBLIC PRESENTATION.

Newspaper and Magazine Advertising.

The financing of an enterprise by means of a general advertising campaign involves magazine and newspaper advertising, followed up by means of prospectuses, letters and other printed matter, may also include circularizing, and is sometimes reinforced by the personal work of agents. The method is always an expensive one and the enterprise must usually be of a speculative nature in order to afford sufficient margin for expenses and at the same time allow for offerings sufficiently attractive to interest the investing public. The capitalization of such an enterprise is naturally high, as a rule running from \$500,000 upwards, and the par value of shares is as naturally low, ranging from \$1 to \$10. It is obvious the stock issued on such a basis—the initial value of the enterprise usually being small—can be sold at the customary first price of a few cents per share without any serious sacrifice of values.

The cost of raising money by a general advertising campaign is excessive—running according to the estimates of those in a position to judge from twenty to fifty per cent. of the total amount secured. In other

words, from twenty to fifty cents must be expended to sell a dollar's worth of stock, and if \$40,000 is raised by means of advertising, from \$8,000 to \$20,000 of this total amount is consumed in the expenses of the operation, leaving a net amount of from \$20,000 to \$32,000 for the development or other purposes of the enterprise.

When the higher costs are incurred the method is barred, save for speculative enterprises. If the cost is fifty per cent., as is often the case, one dollar must be paid for every dollar secured for the use of the enterprise, and if \$20,000 is required for the development of the enterprise, \$20,000 must be expended in securing that amount. At first sight, then, it would seem to be very much better business to merely invest the initial \$20,000 directly in the enterprise without the circuitous and troublesome method of spending it to get the same amount back again, especially as in the process the enterprise parts with stock to the cash value of \$40,000.

The explanation of the promoter's preference for the "longer way round" is not, however, hard to find. The enterprise does not usually possess this \$20,000—or whatever the amount needed—and neither do its promoters—or if these latter have the amount, they are not willing to risk it in the enterprise. Instead, they put up a few thousand dollars to start the campaign, use the returns as they come in for its continuance and reimburse themselves meanwhile from the first returns available for the purpose. In this way the promoter avoids any excessive risk and any personal expenditures beyond the first advance, which

is only sufficient to carry the movement to the point of self-support. When the campaign is well under way it is carried on until the total net receipts—that is, the amounts received in excess of the cost of advertising, general expenses, payments to the promoters, etc.—aggregate the \$20,000, or whatever other amount may be required.

It is obvious that in the end the investor puts up all the money. He pays for the cost of his own discovery, i. e., for the expenses of the campaign, provides also the money for the promoter's first profits and then supplies funds for the development of the enterprise. As to the general results, fifty cents of every dollar the investor puts in is used up in the expenses of the advertising campaign and fifty cents is devoted to the more direct purposes of the enterprise.

Meanwhile the enterprise must assume the entire burden. The money raised is of course obtained by the sale of its stock. As only half the total amount received goes to the proper use of the enterprise—the balance being consumed in the expenses of the campaign—twice as much stock must be sold as would otherwise be necessary. That is, if \$20,000 is required for the enterprise, stock to the cash value of \$40,000 must be sold to secure it. If sold at the average price of two cents for shares of the par value of \$1, as is not uncommon, 2,000,000 shares must be sold to secure the desired amount, or capital stock of the par value of \$2,000,000 is sold to secure a net cash amount of \$20,000. The enterprise must then, to be successful, pay dividends on his excessive stock issue. It is

obvious that any enterprise that can stand such a strain successfully must indeed be one of golden possibilities.

As a matter of fact the majority of speculative enterprises financed or attempted to be financed by this method are failures. Those that do succeed are mainly mines in which the speculative possibilities are larger than in any other class of enterprise.

The cost of raising money by this method, as well as several other features of interest, are brought out with unusual clearness in the interesting report which follows. This was sent to stockholders by the fiscal agents of a company that was being financed by means of an advertising campaign. The company was formed for the purpose of dealing in securities—principally stocks and bonds of mining companies. The statement shows the receipts and expenditures from the time of its incorporation until the date of the report—a period of over a year. The report bears internal evidence of good faith and is probably a correct statement of the transactions covered. Names are changed for obvious reasons, but with this exception the report is presented exactly as sent out by the fiscal agents of the company.

The period covered by the report comprises the first sixteen months from the date of incorporation of the company.

This report is somewhat complicated by the fact that the company was itself meanwhile acting as fiscal agent for the sale of stock in two other corporations. The transactions for these other companies are, however, small and for the purposes of the present dis-

cussion may be disregarded, the items relating directly to these other companies being omitted in the consideration which follows.

Financial report of
THE GOLD MOUNTAIN SYNDICATE.

by
WILKINS & FREEMAN, Fiscal Agents.

RECEIPTS.

Sales of Treasury Stock:

576,870 shares at 1 cent	\$ 5,768.70
484,550 shares at 2 cents.....	9,691.00
88,000 shares at 3 cents.....	2,640.00
23,280 shares at 5 cents.....	1,164.00
21,050 shares at 6 cents.....	1,263.00
27,095 shares at 10 cents.....	2,709.50
3 shares sold to the directors at par.	3.00
Total, 1,220,848 shares	\$23,239.20

From Other Sources:

Received on installments for which no stock is issued yet	\$ 1,826.05
Moneys received from sale of stock in The Mountain Milling Co. (balance due the Treasury of that Company).....	1,924.20
Moneys received due to Treasury of The Consolidated Lead Co.	578.62

(The Gold Mountain Syndicate being Fiscal Agent for these companies under the management of their Fiscal Agents, Wilkins & Freeman.)

Accounts payable (moneys advanced)	478.22
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Total Receipts	\$28,055.29
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Unissued shares in Treasury, 1,779,152 shares.

EXPENDITURES.

Expenses general (current expenses)	\$ 1,085.56
Clerk hire and office help	1,716.40
Accounting to date on account	150.00
Postage	1,398.60
Printing	1,252.68
Advertising	3,043.34
Commissions on sale of stocks (to agents) .	2,270.92
Brokerage (15 per cent. to Fiscal Agents) .	3,629.19
Furniture and fixtures	103.00
Stocks and bonds (purchased as per list) .	12,201.75
Accounts receivable	1,203.85

E. & O. E.	\$28,055.29
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First looking at the sales of stock, we see that the total receipts are as follows:

Proceeds from stock issued	\$23,239.20
Receipts from stock sold but not yet issued .	1,826.05

Total	\$25,065.25
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Now looking at the expenditures we find the following, which may, it is a fair presumption, be charged in full to the cost of the campaign for money:

Postage	\$ 1,398.60
Printing	1,252.68
Advertising	3,043.34
Commissions on sales of stock (to agents) .	2,270.92
Brokerage (15 per cent. to Fiscal Agents) .	3,629.19
Total	\$11,594.73

Out of the general expense for clerk hire and office help, it would not be unreasonable to assume that at least half can be charged to the expense of selling stock. This gives us \$1,400.98 to be added to the total of expenditures for sale of stock, and our condensed statement then stands as follows:

Total receipts from stock sales.....	\$25,065.25
Total expenditures to sell this stock.....	12,995.71
Net proceeds for company purposes....	\$12,069.54

This very rough approximation shows that in order to secure \$12,069.54 for the operations of the company not less than \$12,995.71 was spent. In other words, over one-half of the total amount raised was expended in the campaign that raised this amount, and every dollar secured by the company for its own proper purposes cost the company an equal amount.

It is to be noted that the largest single item of expenditure is the amount paid the company's fiscal agents—\$3,629.19. Commissions to other agents foot up to \$2,270.92, making a total of \$5,900.11 paid out

in commissions and brokerage. If the officers of the company had themselves conducted the campaign, the brokers and agents being eliminated, this amount would have been saved, provided the campaign were conducted with equal ability. An additional expenditure for officers' salaries would have been incurred, however, and it is doubtful whether the general result would have been materially changed. Unless the officials were skilled in the work, the results might not have been as good. If they were skilled it is probable that they would have demanded and received salaries which would have practically equalled the commissions actually paid.

As to the amount of money necessary to begin a campaign of the kind, the following extract from a recent prospectus—quoted freely in a preceding chapter—is in point: "Unless you have at the start not less than ten to twenty thousand dollars to spend in broadcast newspaper and magazine advertising and are prepared to keep the advertisements constantly before the public, you had just as well sink what money you do spend to the bottom of the ocean as expect to get it back in stock sales. This fact has been verified over and over again."

The emphasis of this statement is perhaps accounted for by the fact that the company issuing it is advocating circularizing as the one and only means of raising money. The minimum amount mentioned is higher than is usually deemed necessary. If an extended campaign were undertaken, \$20,000 might be necessary for its inauguration. Usually, however, half or even one-fourth of this is deemed sufficient to

begin operations and to continue them until the movement is self-supporting—that is, to carry them to the point where receipts from stock sales are sufficient to pay the expenses of the further advertising and general work of conducting the campaign.

A local campaign confined to some one district or to special publications might be successfully inaugurated with even less than the prescribed \$5,000. As a rule, however, a very liberal margin should be allowed when an effort of the kind is under consideration, particularly if the parties in charge are inexperienced, as the expenditures are then almost certain to be materially increased. Under any circumstances such a campaign should be begun only after a careful preliminary counting of the cost. A well conducted funeral is a cheerful proceeding compared with an advertising campaign begun with insufficient funds.

The requirements for the underlying enterprise to be financed by this method have already been indicated. It must permit of large inducements to investors—in appearance at least—and attractive possibilities of profit. It should also be of such a nature as to stand the strain of the rather expensive proceedings involved.

The advertising matter of a public presentation must, as a rule, be exceptionally artistic and “purchase-compelling.” The conservative institutions and the great industrial propositions which are sometimes financed by advertising methods do not depend upon working up the enthusiasm of investors to the point of subscription. They merely make plain, cold statements of the facts—or of such facts as they choose the public to know. The public then invests on the

strength of these statements and on the reputation and standing of the parties who make them—not infrequently, as in the first financing of United States Steel and Amalgamated Copper, to their sorrow.

The usual enterprise presented by advertising cannot, however, adopt this plan. The names of its promoters are not often well enough known to be an element of much strength. Nor is the past history of the enterprise or its present condition usually of such a nature as to be in itself an inducement. What does attract the small investor is the low price at which stock is offered—one or two cents perhaps purchasing a dollar share—and the very great possibilities of future profit.

In presenting an enterprise by this method, the safety of the enterprise and the honesty and ability of its management should, of course, be emphasized to the utmost degree that the facts will warrant, but the small investor's great desideratum is large profits, and almost everything else is subservient to this one end. So marked is this tendency that not only are funds secured by Franklin Syndicate offers of impossible profits (ten per cent. a week) without any responsible backing, but the even more barefaced and ethereal "Do You Dare" ads. which neither professed honesty nor promised profits, found material support a few years since on the mere intimation that from some unknown source and in some mysterious way astonishingly large profits might be forthcoming.

For the ordinary honest enterprise, however, due regard must be paid to the decencies of financing. The facts as to the present condition of the property

and the standing and ability of the management must—if stated at all—be stated exactly as they are. Also any facts as to profits, if stated, must be facts. Usually, however, when we come to profits, facts are unattainable and the promoter has free sway to make the best use of the materials he can. Nothing short of development can determine what these profits will really be and the promoter is therefore entitled to state his beliefs and expectations as strongly as he sees fit.

It is not infrequent to hear the profit claims of such prospectuses denounced as false and misleading. Some of them unquestionably do go too far, announcing the beliefs and expectations of the promoters as facts. This is, of course, entirely unjustifiable and is liable to bring the promoter within the grasp of the law. He may, however, express his own convictions and beliefs, stated as such, as freely as he pleases, and the promoter whose inner convictions will not stand the strain of the most glowing presentation the occasion can possibly demand, has either mistaken his calling or has stumbled on an extraordinarily poor property.

In this connection an extract may be allowed from Mr. Rowell's very interesting work, "Forty Years an Advertising Agent." This describes the difficulty in securing suitable advertising matter for a patent medicine which he was then about to exploit. The principles involved are much the same as those with which the promoter must struggle when an enterprise is to be financed by public presentation. Mr. Rowell says: "There is an unsuspected difficulty, too, in preparing advertising matter that will not seem tame and valueless beside the more glowing announcements that

appear daily in the public prints. * * * It seems to be universally admitted among those who have had most experience, that in the announcements that are issued the advertiser must put it strong. 'You are starting out on a long up-hill journey,' said a man to me whose life had been spent in kindred lines, 'and you must write your advertisements to catch damned fools—not collège professors;' then, after a moment, he added, 'and you'll catch just as many college professors as you will of any other sort.' "

The somewhat roughly expressed ideas of Mr. Rowell's adviser must not be taken too literally, but their underlying truth will be recognized by any promoter experienced in public presentations. A calm, direct and accurate statement of facts would not attract. A more alluring presentation is absolutely essential. Usually this requires advertisements and printed matter of a high degree of excellence—not always as literature perhaps, but certainly as to attractiveness and general effectiveness. Very occasionally this seems to be attained by the rule of contraries when a poorly worded, badly printed and generally defective prospectus succeeds from the mere fact of its crudity. Seemingly the roughness of the prospectus is taken as an evidence of the simple honesty and sincerity of the people behind the enterprise. This frame of public mind cannot, however, be relied upon and the prospectus and other printed matter must usually be the most attractive and persuasive that can be devised.

The great defect in most prospectuses used in public presentations is, from the standpoint of the more intelligent investors, an evasion or avoidance of the

facts which must be known before the safety of the enterprise, and, dependent thereon, the safety of investment can be judged. In the better class of public presentations these facts are gone into with commendable detail, but in the reckless financing so frequently attempted by this method they are usually evaded or omitted. When absolutely fraudulent enterprises are presented by advertising methods, these features are sometimes presented in full detail, and, notwithstanding the falsity of the alleged facts, with such cleverness and verisimilitude of truth as to deceive the very elect.

In the prospectus of any legitimate presentation the capitalization and its connected details should be given; any property owned by the company be described; the way in which it was acquired be stated, and the manner in which it is held and the consideration for its transfer to the company be clearly set forth. The name and personal standing of each member of the management should also be given, or at least of those actually in charge; the financial condition and needs of the enterprise should be explained, and in short all the facts that a good business man would wish to know before investing should be set out clearly and without evasion. Where this can be done the presentation is, if the facts are favorable, the profit possibilities good and the offer liberal, a very strong one and should carry. If the conditions will not permit of such a statement, the unfavorable facts should of course be presented in the best light possible or else be avoided entirely, so far as it can be done without material concealment.

CHAPTER XXXIV.

PUBLIC PRESENTATION.

Newspaper and Magazine Advertising.

(Continued)

In a public presentation by newspaper and magazine advertising the selection of the advertising mediums—that is, the publications to advertise in—is a matter of paramount importance. Their selection will be governed by the kind of enterprise that is presented, the funds at command and the offer that is to be made. The larger, bolder and strongly backed enterprises will select the daily papers of the larger cities, preferably the Sunday editions, taking on occasion whole pages. A thousand dollars a page is, however, rather heroic treatment even for a robust advertising appropriation, and most enterprises seeking publicity will avoid these papers or take small space. The financial, investment and mining papers are favorite mediums. The technical publications are sometimes good, and special enterprises will frequently indicate by their character the mediums in which their advertisements should appear.

For the inexperienced promoter this whole matter of advertising and selecting a medium is one of much difficulty. Usually he does not know to just what

classes his enterprise will appeal, or in what part of the country they are to be found, or what publications will reach them. He may, of course, determine the matter by actual experiment, but this is a procedure involving time, trouble and much expense. Probably in any case of the kind the employment of an advertising agency will be advisable. There are unsuspected possibilities of assistance in these agencies and they can frequently be employed to great advantage.

In some cases it will be found advisable to put the whole matter in the hands of a financial agent. In such case the financial agent will undertake the whole campaign for a percentage of the proceedings, or perhaps a certain amount for each share of stock sold. The scope of the financial agent's work and his compensation vary with the conditions and the arrangement. In the report given in the present chapter it will be noted that the fiscal agents receive fifteen per cent. of the gross proceeds. In some of the easier flotations the percentage may be less. As a rule, however, it will be at least fifteen per cent. and frequently much more, particularly when the financial agent advances money for the preliminary expenses of the campaign, as is occasionally done. His work is of the greatest importance, requires skill and experience, and demands and receives a fair compensation.

The newspaper or magazine advertising of a public presentation is usually intended to be merely the first step towards the sale of stock. If the advertising is successful, some few subscriptions will be received in direct response, but these, though welcome, are entirely incidental, the main object of the advertising

being to secure the names of people who are interested, or who may be interested in the investment. Subsequent efforts are then required to work this interest up and turn it into stock subscriptions.

It would of course be very advantageous if subscriptions could be secured at any reasonable cost in direct response to advertising in the public prints. The "follow-up" involves trouble, expense and delay, and if avoided the saving would be material. To this end advertising is sometimes framed on mail order lines, the idea being to make the presentation so complete or so satisfactory in itself that the reader, instead of sending for circulars or further particulars, will at once forward his subscription. The attempt is but seldom successful. A fairly complete presentation, requiring considerable very costly advertising space, is usually necessary to produce such results, and it is but rarely that the advertiser has this space at command or could produce results that would justify its cost if he had.

Occasionally, it must be admitted, an advertisement of moderate size is seen in which the presentation is made so concisely and yet effectively that it does produce direct subscriptions. On the other hand, advertisers sometimes disregard the limitations of cost, and print what is practically a complete prospectus in the advertising pages of magazines or other suitable publications. This is done on the assumption that direct subscriptions will be secured and that the elimination of the delay and expensive follow-up work thereby effected justifies the somewhat excessive expenditure.

It may be said generally that any advertising that pays is good advertising, but the wisdom and economy of making a full presentation of the offering—unless it can be briefly done—in the costly advertising pages of newspapers and magazines, is always a matter of grave doubt. Advertising in any desirable medium seldom runs less than \$100 a page, and ranges upward from this minimum to the thousand or more dollars paid the newspapers of the larger cities for page advertisements in their Sunday editions. It is obvious that in any legitimate enterprise the subscription returns must be very large to justify such a presentation cost, and in practice such results are not often secured.

If the attempt is to be made, the Sunday newspaper—the most expensive advertising of the kind—will probably produce the best results. It is but seldom, if ever, that the extended presentations which appear on occasion in the monthly magazines are profitable. The lengthy and interesting prospectus of the Cash Buyers' Union, which appeared some years ago in the advertising pages of some of our popular magazines, affords an excellent example of an attempt of this kind. The presentation occupied from eight to ten pages and hardly cost less than \$100 a page in the cheaper mediums. In the better mediums the cost was much greater. The ensuing bankruptcy of the concern with net liabilities stated to be over \$1,000,000 was to be anticipated, not as a direct result of this advertising, but as the general result of the extravagant and reckless management of which such advertising is apt to be indicative.

The advertising of a public presentation usually

includes a request to send for a prospectus or other printed matter. Sometimes responses are encouraged by special inducements. A mining enterprise will offer to send samples of ore to all applicants for its prospectus; a plantation company will give handsome photographs of its property; other advertisers will include some publication of small cost but attractive title, as "How Money is Made," "The Road to Fortune," "The Investor's Guide," "The Gates of Gold," etc., etc., the whole object being to attract attention and interest people to the point of sending in their names.

It is doubtful whether inducements of a popular nature, such as samples of ore or photographs, are ever advantageous. It is almost certain that at times they are distinctly the reverse. Many people respond merely for the sake of securing the offered inducements without the least interest in the underlying enterprise or in investments generally. In such cases the names are of no more value than if they were copied at far less expense from some public directory.

Booklets of the kind mentioned, which appeal directly to the classes of people to be reached, i. e., investors, are much better. Even though the party responding writes merely to secure the booklet, it is a fair presumption that he is interested in investments generally and may by judicious treatment be interested in the particular investment under consideration.

A name secured in response to advertising is a far more valuable property than one obtained from a purchased list. It presumably represents a fresh "unworked" enquirer—a prospective investor looking for

an investment and already interested in the particular enterprise. The application is therefore treated with all due consideration. Usually a fac-simile or circular letter accompanied by a prospectus is sent at once to the enquirer. An order blank and return envelope are also enclosed with these. Occasionally, in addition to the material mentioned, a mass of other printed matter is included. This, however, is apt to be prejudicial, as too much material is unattractive and confusing, requiring study in order to fit each piece in its proper place and preventing that easy assimilation of the whole presentation which is desirable. The addition of a map or report or special proposition is good if it strengthens or adds interest to the presentation, but not otherwise. As a rule, any presentation material, outside the fac-simile letter, should be incorporated in the prospectus. Or, if not closely enough connected to appear in the body of the prospectus, this other matter may be bound up with it in the form of exhibits. It is hardly necessary to add that printing and paper should be at least good enough to be attractive, that each piece of matter should be neatly folded, and that the whole should present a clean business-like appearance and be "confidence-inspiring."

The inclusion of an order blank and return envelope is almost invariable and is advisable on the general principle that anything is good which makes it easier for the recipient to send in his subscription. Nothing is so dangerous as delay when an investor's mind has once reached the subscribing point. The general motto of present-day advertising is "Do it now," and the mere fact that the party has no envelope at hand, or

cannot find a sheet of letter paper is quite sufficient to defer a subscription, and a deferred subscription so frequently means a lost subscription that every care should be taken to prevent postponements. The return envelope is sometimes stamped as a means to this end. The practice is of doubtful value. It is expensive and is too obviously and anxiously a smoothing of the way.

If the prospectus and accompanying material sent out to an enquirer produce no result, they are followed up and supplemented from time to time by follow-up letters or other printed matter. The follow-up letters are usually sent out at intervals of a few weeks. Their composition affords unlimited room for skill, as results are directly dependent upon the excellence of the letters. Sometimes the follow-up letter will be an actual personal letter, and this is particularly desirable where any special reasons or local conditions may thereby be brought to bear upon the particular enquirer.

When form letters are used every effort is made to give them a personal tone. The body of the letter will be a faithful reproduction of a typewritten letter. The signature at the end will either be actually written with pen and ink, or else be printed in fac-simile so as to give a faithful reproduction of a real signature.

Nor does the personalization of the letter stop here. At times in the preparation of such a letter the first and last paragraphs, or perhaps some intermediate paragraph, will be omitted entirely and be written in at the time the letter is used, some local name or reference being introduced. A suitable blank will also be left here and there in the body of the letter for

the insertion of the name of the party addressed or for some reference to the town or village in which he lives.

When such a letter is skilfully filled in, it may not perhaps deceive the elect, but it sometimes has them puzzled.

The number of follow-up letters sent will vary with the conditions, with the enterprise, the results secured and the ideas or practice of the particular concern. Sometimes an enterprise will in a short time secure all the money it needs, and then follow-up letters will naturally cease. Usually at least half a dozen such letters will be sent at proper intervals before a name is dropped. In continuing enterprises, or in the case of a concern which finances successive enterprises, follow-up letters and printed matter will sometimes be sent to an enquirer for years before his name is "killed," even though after the first enquiry no response has ever been received.

Of the value of the follow-up letter there can be no question. Ordinarily if an enquirer is willing to go to the trouble and expense—trifling though it may be—of responding to an advertisement, he is almost certainly interested. It is true that if injudicious inducements are offered, such as free samples of ore, pictures, etc., an avalanche of responses are likely to be secured from people who neither have the desire nor the money to invest and who are therefore not worth following up. Also in all cases there will be some few responses from people impelled by mere curiosity or a general desire to keep in touch with work of this kind, and these names are likewise of but little value. The

great majority of responses will, however, be from parties who either are interested or who may be interested, and a list of names so secured is of people who have money to invest and who are looking for investments.

These names are choice names and a failure to respond to the first appeal is not even a discouraging symptom. A thousand reasons may account for the first failure. The presentation may not have been sufficiently attractive; the terms may not have been quite right; other demands may have diverted the immediate funds intended for investment; the enquiry may have been made with a view to the future; the matter may—as is often the case—have been postponed temporarily, or the party, while favorably impressed, may not have been interested to the point of investing.

In any of these or in many other cases that arise, the follow-up letter may produce results. Not knowing just what the difficulty is in each particular case, these letters can only strike at it in a general way. The various letters should, however, take the matter up from different standpoints and each letter, if skillfully prepared, should meet the objections of, and succeed in interesting a certain number. A general “whoop-’em-up” letter will sometimes decide the hesitating. An offer of special terms of payment may bring in a number more. An offer to reserve a certain number of shares before the price of these shares is raised may prove attractive to others. At all times a letter announcing progress or new facts of material advantage is good. Sometimes a follow-up letter will

be sent enquiring directly why no response has been received to preceding communications. Such a letter is sometimes excellent, but must be very tactful and courteous to produce good results. If otherwise, it is almost sure to be offensive, and is then much worse than no letter.

It is to be borne in mind that follow-up letters, if not prepared with skill, or if too frequent, are apt to become irritating and have exactly the reverse of the effect intended. In one case known to the writer, no less than twelve follow-up letters were received in as many weeks. The letters were not bad, but there were too many of them. The first effect of this hot pursuit was irritation, changing later to amusement. Neither effect was good. When, however, the follow-up letter is not too long, is well prepared, is of interest, not too frequent, and, above all, is good-natured or business-like in its tone, the results are almost always good. With a suitable list of names, a good follow-up letter to the second or third edition, and even further, should bring profitable results.

Various devices are used to reinforce the printed matter and increase the general effectiveness of an advertising campaign. One very familiar plan is to fix a certain date for an increase in the price of stock. Frequently this is an arbitrary advance at an arbitrary date, though of course founded on the assumption that the development of values behind the stock justifies the increase. However this may be, it is announced that on a certain date the increased price of stock will be effective and the purchasers are besought to enter the fold before their entrance is made difficult

by the higher price. Usually about the date for the advanced price to become effective, a follow-up letter gives notice of the imminence of this increase, but also states that stock will be reserved at the old price for anyone making immediate application, payment to be made within some specified time, as in thirty, sixty or ninety days.

At the appointed time the price is raised. As a rule purchasers coming in within a very short time thereafter—if they will not pay the advanced price—are slipped through on the old basis. The general sale goes on, however, at the higher level and the increased price is pointed to as absolute and final proof of the solidity of the enterprise and the profits accruing to its stockholders. After a decent interval another raise is announced and the campaign again swings round the same interesting and effective circle.

The report printed in the preceding chapter affords a very graphic exposition of this practice, showing both the manner and the results. As will be noted, sales began at one cent a share, at which price the largest number of shares were sold. The largest receipts, however, came from the sale of stock at two cents a share. This is probably due to the fact that the price of stock was then still at an attractive figure while the increase in price had given confidence in its future. From two cents, as will be seen, the stock went to three cents, five cents, six cents and finally to ten cents a share, good results being secured at each of these advanced prices, though not at all equal to the results of the first offerings at one and two cents.

Such increased prices are usually justified—nomi-

nally at least—by the improved conditions of the enterprise or by new discoveries made, as a pay streak or a rich pocket in a mine, or by the acquisition of a new or competing invention, or the closing of a profitable contract in an industrial enterprise. Sometimes, however, they are justified by the mere fact that the enterprise has been widely advertised, that money has been secured for the treasury, that a market has been created for its stock and that, therefore, the stock is worth more than before.

As a stock-selling measure the plan is common and effective and can hardly be condemned.

Another favorite device for the furtherance of stock sales is to announce the conclusion of the sale. The following announcement of this kind is taken from the recent circular of a house dealing in one of the wireless telegraph stocks: "This is absolutely our last offer of these securities at this price. There will be no more for sale. You will do well to take advantage of this final opportunity and order all you can possibly take at our price of \$7 per certificate."

The general idea of such an offer is entirely proper and is frequently an effective measure, but in this particular instance, as the same stock was then being offered and is still offered quite freely on the open market at figures much less than those of the promoters, their final offer seemed to be lacking both in inducement and in satisfactory conclusiveness. Too many "last appearances" tend to destroy confidence.

In connection with a public advertising campaign of the kind under discussion, it is not unusual for the fiscal agents or other parties in charge to appoint

selling agents in different parts of the country, who will call upon enquirers and endeavor to secure their subscriptions. The effect of personal work of this kind is, of course, much better than printed matter alone if the agents are men of ability, though occasionally people object to this "follow-up" method. When agents are employed the names of enquirers in their territory are sent to them as received at the central office. These enquirers are then usually left entirely to the agent for subsequent work, though if the agent is unsuccessful, follow-up letters and printed matter are sometimes again sent from the central office to these hard-headed enquirers.

Sometimes the financing of speculative enterprises is carried on mainly or entirely by means of these agents. Usually, however, advertising is also carried on to assist and reinforce their work. When this is not the case, the agents who have the matter in hand must of necessity either be men possessing a circle of friends or acquaintances to whom they can present the matter, or otherwise be capable of securing access to desirable parties. The whole presentation then becomes one of personal appeal governed by the same principles as in any other private presentation. The method is effective but is expensive and could hardly be satisfactorily used for the financing of a single enterprise.

Such methods are usually employed by concerns which finance one enterprise after another, the same machinery being used for all. In such case an attractive enterprise is taken up, capitalized liberally and the stock placed for sale in the hands of these

canvassers. These agents are usually supplied with effective printed matter, and the details of the campaign are left in their hands, subject only to general supervision and direction from the central office.

In conclusion it may be said that the field of financing by public presentation, whether the campaign be by circular letter, by agents, by the usual advertising methods or by any combination of these, is extensive. There is practically unlimited money ready for investment if it can be reached in the right way. The method, however, requires an attractive proposition, a skilful presentation and favorable conditions. All of these must be present, and even then success is not always attained.

Sears, Roebuck & Company, the mail order house of Chicago, afforded an unusually good illustration of a successful public presentation of stock. This business was incorporated under the laws of New York State with a capital of \$40,000,000, of which \$10,000,000 is a seven per cent. cumulative preferred stock, redeemable at any time upon payment of one hundred and twenty-five per cent. This preferred stock was offered largely in New York City at a price of ninety-seven and one-half per cent. with accrued dividends from July 1st, 1906.

In this case the securities possessed no speculative attraction, and whether they had sufficient solidity, convertibility and fixed return to appeal to the conservative investor was then doubtful. The offer was first made by circulars sent to selected names. This was followed by a general presentation in the public prints. The campaign was managed with considerable

skill, and if any difficulties were encountered they were due to the nature of the offering, not to deficiencies of the presentation. The subsequent history of the company has justified the public confidence with which its stock was received.

PART VI. SPECIAL FEATURES OF PROMOTION.

CHAPTER XXXV.

TRUST FUND GUARANTEES.

In the promotion of speculative enterprises, and particularly in the promotion of mining enterprises, various methods of avoiding or diminishing the risk to the individual investor have been sought,—not usually out of regard to the investor, but to add to the attractiveness of the enterprise. Of the methods now in use the best known are those termed the “trust fund” and “guaranteed stock,” both having the same general object of reducing the investment risk.

In passing it may be said that these terms, when used in their “promoting” sense, do not carry the real weight and safety supposed to characterize the same terms when used in general finance. They were presumably selected for the reason that they do bear some likeness to their distant relatives of ordinary finance, and because they do have a conservative and confidence-inspiring sound.

In the general consideration of these alleged protective measures—the so-called “trust fund” and “guar-

anteed stock"—it is assumed that they are employed and made effective in good faith. It is certain that in many cases these assumed conditions do not obtain. It is equally true that this improper employment of the devices—which are legitimate enough in themselves—has brought them into an odium and disrepute which is not entirely merited.

The "trust fund" is a form of industrial insurance sometimes used by promoting concerns for the purpose of protecting or guaranteeing their investors. These concerns make a practice of taking up and floating one speculative enterprise after another. They usually pose as financial agents of the enterprises exploited. They might perhaps be more correctly designated as owners and promoters, as the enterprises are usually, in fact if not in name, their own.

The general plan of the trust fund is as follows: Each enterprise taken up by the concern employing the device is capitalized at a liberal figure. This capitalization is rendered "full-paid and non-assessable"—in name at least—by its issue in exchange for the patents, mines or other property forming the basis of the enterprise. A portion of the stock—usually termed "promotion stock"—is retained by the owners or promoters. A portion is returned to the treasury to be sold in securing money for the development of the enterprise, or for other company purposes. Any special demands upon the stock are then satisfied and the remainder is reserved for the alleged protection of the concern's investors. This is the so-called "trust fund."

The proportion of stock reserved for this trust fund

varies with the conditions of the particular fund. It is presumable, however, that as the managing concern is generally the "residuary legatee" of the trust fund, the proportion reserved will be liberal. Each enterprise capitalized contributes in this way its quota to the trust fund. Then if any one of the enterprises fails or is not sufficiently profitable to justify further operations, that enterprise is dropped and its outstanding stock is replaced with some other stock—either of demonstrated value or of undemonstrated worthlessness—taken from the trust fund.

The amount of the trust fund, the methods of its application, the disposition of any dividends accruing, and the other details will of course, lying as they do entirely within the province and absolutely within the discretion of the concerns creating them, vary materially in different cases. The general plan is, however, the same, stock of each concern financed being reserved for the protection of the investors of the general series. From one point of view this reserve is really a trust fund, being held by the concern creating it in trust—to a greater or less extent—for the general benefit of stockholders in the particular chain of enterprises.

The usual claims of promoting concerns as to the effect of the trust fund are as absurd as they are irresponsible. At the same time the basic idea of the trust fund is neither unsound nor improper. If a number of enterprises are selected with the care and scientific knowledge that would be easily possible to a strong, well-equipped concern, and if these enterprises are at all well managed, it is obvious that a

proportion will be successful. Also as these enterprises are of a speculative nature it is probable that the successful ones will be largely profitable. It is clear, then, that if any reasonable proportion of the stock of each one is reserved and held as a protection against the failure of any one or more of the enterprises, the risks of the investors in each particular enterprise fostered by that concern will be much diminished. So far the scheme is good and to be commended.

It will be recognized, of course, that a trust fund composed of worthless stocks is of no protection to anyone, and when so constituted, as seems to be the case in several prominent examples of its use, it is nothing more than an ordinary, or extraordinary, swindle. Such funds are not considered here.

Even when it is honestly constituted, however, there are in practice points of disadvantage connected with the trust fund that do not appear at first sight. The most important of these relate to the methods by which the fund is held, to the limited security it affords and to the diminution of general profits when it is employed.

Trust funds of the nature under consideration are in most cases held and managed by the promoting concern which creates them. This control is usually absolute. The restrictions under which the fund is held are determined and fixed by the holding concern. If these are good and the particular concern administers the trust fairly, the fund may be a very excellent institution. If, however, the proper restrictions or regulations are not provided, and the concern in

charge is disposed to administer the fund unfairly or even improperly, the opportunity is there.

Under these conditions the questions naturally arise when any investment protected by a trust fund is under consideration—what are the exact rights of stockholders in this fund, or have they any absolute rights, and if so, what assurance have they that these rights will be recognized? The answer to these questions is but seldom, if ever, as explicit as would be desirable. In most cases it is lamentably evasive and deficient.

Not only are the general conditions of the trust fund and the status of its "protected" stockholders uncertain, and therefore unsatisfactory, but in most cases the controlling concern is, as already stated, the residuary legatee of the fund. In other words, any stock or cash of the trust fund not paid out in the protection of stockholders ultimately reverts to it. Every dollar kept from the stockholders comes into the hands of the concern. We then have the spectacle of a trustee in absolute control whose interests, in part at least, are directly opposed to those of the parties for whom this trustee is acting. Obviously the conditions are not such as to create any great amount of confidence either in the trust fund or in its trustee.

It is not at all improper that the controlling concern should be the residuary legatee of the trust fund. It would seem perhaps fairer that any remainder should revert to the stockholders of the protected enterprises, but the reversion to the managing concern is legitimate if so arranged and agreed to by those interested,

and does to some extent serve as an incentive to a careful selection of properties for development and a conservative management thereafter. The uncontrolled administration of this fund by the managing concern is, however, grossly improper and sufficient in itself to cast suspicion on the whole arrangement.

As to diminution of profits we come to the general proposition that obtains in any form of insurance, that any protection secured must be paid for. In the case of the trust fund it is obvious that if it is to be effective a considerable proportion of the stock of each enterprise must be reserved, and this necessitates an increased capitalization.

Ordinarily the capitalization of a speculative enterprise is large. Stock must be issued for the properties secured, promoter's profits must be provided for, and sufficient stock must be reserved for sale to cover the heavy expenses of financing and to produce an adequate operating capital. When the trust fund is employed, in addition to these ordinary requirements, its reservation must also be included. The company is therefore capitalized at a materially higher figure than would otherwise be necessary, and as the value of each share is thereby decreased, each individual stockholder involuntarily contributes his *pro rata* to the trust fund reservation and thereby pays for its protection. That is, if he buys 10,000 shares in the "protected" company—shares being \$1 each—instead of getting 10,000 shares in a company capitalized at perhaps \$1,000,000, he gets 10,000 shares in a company capitalized at perhaps \$1,200,000 or \$1,500,000, this larger capitalization being imposed upon the cor-

poration in order to allow for the trust fund reservation. In other words, instead of getting 1-100th of the whole capitalization for his money, he gets 1-120th or 1-150th. His interest in the mine or other subject matter of the enterprise is therefore smaller than would otherwise have been the case, and of course his participation in dividends is diminished in an equal proportion.

It is also to be noted that usually when a trust fund is created the capitalizations of the protected enterprises are not increased solely by the amount reserved for the trust fund, but, on the mere strength of having a trust fund, are jumped up arbitrarily to an unnecessarily high figure. This "unearned increment," it is only fair to presume, inures to the benefit of the promoters and financial agents of the enterprise.

In any case it will be seen that the "financial agent" or the concern managing the matter does not in any way bear the burden of this trust fund—except possibly as a stockholder of some or all of the enterprises—but that it falls entirely on the stockholders themselves. That is, these latter get a certain amount of insurance and they pay for it. Whether they pay more than its worth is difficult if not impossible for the ordinary stockholder to tell, as the matter could only be determined by an "inside" and somewhat intricate investigation.

The general idea of industrial insurance involved in the trust fund is sometimes worked out on a different and simpler basis. Under the trust fund arrangement the concern in charge takes up a number of different enterprises and capitalizes and floats them

separately, reserving a quota of each capitalization for the common protection. Under the simpler arrangement referred to, but one large corporation is organized and the different enterprises to be developed are taken up by this one large concern. Each enterprise then is included with the others under the one capitalization and instead of stock being sold in each particular enterprise as under the trust fund system, stock is sold only in this main company. Each stockholder is therefore interested in and his stock is supported by every one of these enterprises.

If the enterprises of the large or exploiting company are well selected and no special ill luck is encountered, the company as a whole will be successful. If any one of the enterprises fails, there are no individual stockholders in that particular enterprise to be recouped, but the loss falls automatically on the company at large. In other words, the stock held by each stockholder is worth less than it would have been had that enterprise been successful, but, being based on a number of enterprises, still has a value dependent on the value of those which still remain. The plan is superior to that of the trust fund in several respects.

It may seem paradoxical, but under the usual trust fund scheme the original stockholders incur losses whether business losses are sustained or not. In other words they have to pay for their insurance.

In a large exploitation company, on the contrary, losses are automatically adjusted as they are met. In other words the company carries its own insurance. There is no reservation of stock as in the trust fund; there can, therefore, be no profits on an over-reserva-

tion to the managers. The protection is more complete, because every enterprise is pledged to the limit of its value. As long as one single enterprise is a success, each stockholder has something to show for his investment.

To summarize the whole matter it may be said that the abstract theory of the trust fund is correct, being an application of insurance methods to business enterprises. All contribute in order that none may lose entirely, and the risk in each particular enterprise is thereby to some extent diminished. In the large exploiting company taking up a number of enterprises under one capitalization, the same protection is automatically afforded, but with simpler machinery and to a greater extent. In neither case is the protection complete. The number of enterprises developed by even the largest concern is small and a series of disasters might, under the trust fund plan, wipe out the whole reserve and remove all further protection, or, under the exploitation company, so reduce the assets and possibilities of the concern as to remove all hope of adequate profits and involve its stockholders in a more or less serious loss.

It may be said further that as a matter of practice there are a number of well known exploitation companies now in successful and very profitable operation. These companies are of large capitalization and even larger assets. They are of recognized standing, reputation and responsibility. They are conspicuous examples of success.

On the other hand, there is no single instance known to the writer of similarly conspicuous success under

the direct trust fund plan—except, indeed, when used as a means of swindling. As the basic principles of the trust fund are correct, this practical failure in operation can only be attributed to the manner in which these principles are carried out.

It is obvious that dividends on stock and interest on bonds, as well as the bonds themselves, can be guaranteed—as far as may be—by this same trust fund device. The principles involved are, however, identical with those already discussed and require no further consideration.

CHAPTER XXXVI.

GUARANTEED STOCK, BONDS AND DIVIDENDS.

As stated in the preceding chapter, the mere inclusion of a number of different enterprises under one large capitalization gives a measure of safety to investors in the stock of that company not enjoyed by stockholders in a "one-enterprise" company. If the enterprises are well selected, it is not likely that all will fail, and unless this occurs the company itself cannot be an entire failure.

Also if a trust fund is formed by the reservation of stock from a number of different companies and is honestly held as an insurance reserve to make good any losses resulting from failures among these companies, a certain measure of protection is again secured.

For the ordinary company formed to develop but one enterprise and not acting in conjunction with other companies, neither of these methods of protection is available. It is, however, very desirable from the standpoint of the promoter to add to the attractiveness of the one-enterprise company by some protection—or alleged protection—for its prospective stockholders, and this demand has led to the invention and employ-

ment for promotion purposes of guaranteed stock, bonds and dividends.

In conservative finance these terms mean that the stocks or bonds so designated are guaranteed as to principal, interest or dividends by substantial concerns, as for instance when a connecting railroad is taken over by some trunk line and the bonds of the connecting road are actually guaranteed by the trunk line as a part of the purchase consideration, or as when a subsidiary company issues bonds or preferred stock guaranteed by the parent company.

The guarantees of promotion usually provide that at some future specified date the face value of the guaranteed stock or bonds will, on surrender of the securities, be paid to their legal holders, this guaranty being made by institutions not connected with the issuing company. In the case of guaranteed bonds, the guaranty is much the same as that of sounder finance, usually differing only in the standing and character of the guaranteeing company. In the case of stock the guaranty is of a different nature, providing that at some fixed date, if the purchaser of such stock is not satisfied as to its value, he can surrender it to the guaranteeing company and receive its full face value. If dividends or interest are guaranteed the guaranteeing company either undertakes their payment absolutely or agrees to pay such interest or dividends in case the issuing company fails to do so. The details of any of these guarantees will, of course, vary according to the arrangement in each particular case.

These guarantees are absolute as far as they go.

In the case of bonds the guaranteeing company agrees to pay the holder the face value of his bond when due if the issuing company does not. In the case of guaranteed stock the agreement to pay its face value at the specified time is also absolute, but payment, if made at all, may be either to the holder of the stock or to the company which issues the stock, according to the conditions. If the stockholder so elects, payment will be made to him. He must, however, in this case, surrender to the guaranteeing company the certificates for his stock, and these must be duly assigned. He then receives his money from the guaranteeing company, the stock certificates received by the guaranteeing company are turned over to the issuing company, and the transaction is closed. If, however, the stockholder prefers to hold his stock instead of surrendering it, he can do so, but then the money that would otherwise have been paid the stockholder is paid to his company instead, the guaranty on the stock lapses, and the transaction is again closed.

For instance, let us suppose that payment of a hundred dollar share of stock is guaranteed at the end of fifteen years from the date of issue. The purchaser will usually pay the par value of \$100 for this share. He receives it under a guaranty that at the end of fifteen years he may surrender it if he wishes and receive therefor \$100 in cash. If at the end of the guaranty period the stockholder finds the company a partial or total failure, he will naturally be glad to turn in his stock and get back the amount he originally paid. Then he has received back his original investment, surrendered his stock and is out of the

game. If, however, at the redemption date the company is successful and is paying handsome dividends, the stockholder will as naturally prefer to remain in the company and take his profits. In this case he retains his stock, the cash payment of \$100 for which the guaranteeing company is liable is made to his company instead of to him, and his stock is no longer guaranteed.

Occasionally the terms of the guarantee will be so varied that the stockholder receives the guaranteed amount at the end of the specified period without the surrender of his stock. This is, of course, a better arrangement for the stockholder, but does not affect the principles involved.

In any case it will be observed that the guaranteeing company is to pay the face value of the stock at the specified time; if not to the stockholder, then to the stockholder's company. It is obvious, therefore, that some substantial consideration must be given to the guaranteeing company to induce it to thus stand behind the guaranteed securities.

This consideration consists of a direct cash payment, its amount—though much less than the amount called for by the guaranty—being such as to absolutely secure the guaranteeing company from loss, for the simple reason that at compound interest it will by the date the guaranteed payment is due, aggregate more than the moneys to be paid.

The payment for the guarantee is made to the guaranteeing company by the company issuing the securities. While this is the actual procedure, this payment in fact comes out of the money given by the stock-

holder for his guaranteed stock. The payment is usually made by the company in advance of any sales, or at the time of sale, in order to secure the guaranteed stock for delivery, but the company recoups itself from the stockholder's money as soon as the sale is made. This, then, throws the burden on the stockholder to the same extent as if the payment were made directly by him, so that in practice when a stockholder pays for a share of guaranteed stock, a substantial portion of his payment goes to the guaranteeing company and the balance goes into the enterprise.

The plan is a most ingenious one. The terms used are familiar, respectable and confidence-inspiring, and the mechanism employed is unknown to the ordinary investor and difficult of just comprehension. The following quotation from the prospectus of a mining enterprise shows how it is presented to him:

"GUARANTEE AGAINST LOSS.

"Any sound-minded, conservative reader of the foregoing pages assuredly can not fail to be impressed with the stability and merit of the proposition, but in order to remove it entirely from the category of speculative enterprises, we have added a special feature which eliminates the minutest element of risk which naturally exists in every business venture, no matter how conservative or well founded.

"Ordinarily the man who invests in stocks of any kind places his capital at the disposal of the corporation and takes his chances equally with others who have shown a similar degree of confidence in the

undertaking. Our proposition to you is of a vastly different character, for the reason that while offering you an opportunity to participate equally in the profits of our Company, we do not ask you to assume one particle of risk; in other words, if the claim we have made and the plans adopted prove unsuccessful, the entire amount of your investment will be returned to you intact.

“After a most rigid investigation by experts, appointed to judge the merits of our proposition, we have succeeded in making an arrangement with a well known financial institution to issue us its gold bonds, same to be delivered to our investors with their stock as an absolute protection in case of the failure of our enterprise. These bonds will be issued in denominations equal to the amount of your investment, payable at a specified date. Nothing could be fairer than this; you are sure of the return of your principal in any event.”

It is a fair presumption that the “rigid investigation by experts” of the foregoing quotation is drawn from the imagination of the writer of the prospectus. The average guaranteeing company cares nothing about the merits of the proposition. Its guaranty is based on the much more solid security of cash in hand.

It is to be noted that in this case the guaranty is accomplished by means of a bond delivered to the stockholder with his share of stock at the time of purchase. The bond is employed, as explained later, to avoid any possible conflict with the corporation laws against impairment of capital stock by payments to stockholders. The effect is exactly the same as a direct guarantee of the stock.

As the matter appears to the purchaser of guaranteed stock, he may at the specified date, if not satisfied with his investment, surrender his stock and get the full amount of his money back. The small investor has but few "doings" with interest and therefore considers that when he purchases stock of this character he is at least fully protected against loss. He may not realize profits, but he cannot lose anything. In other words, he has all the speculative possibilities of profits without the speculative risk. This seems attractive, and large amounts of money have been invested in guaranteed stocks entirely on the strength of their superiority to the ordinary unprotected securities.

As a matter of fact, however, the guaranteed stocks and bonds of promotion do not protect. It is obvious that the guaranteeing company, not being a philanthropic institution, must receive a full *quid pro quo* for every penny it pays out on its guaranty, as well as payment for its trouble in addition. This *quid pro quo* is an amount of money sufficient to produce the amount of the guaranty within the specified time, and this money comes directly from the stockholder's pocket. It is merely a part of the money that he has supposedly paid for his stock, laid aside at compound interest to be returned to him—less the fees of the guaranteeing company—at the specified time if he then deems the money better than his stock.

Or the matter may be expressed in another way. The purchase of his stock is not final. Part only of the price is actually paid over to the company which issues the stock, the balance being escrowed or held

in trust by the guaranteeing company till the stockholder determines whether or no he wishes to take full title to his stock. At the end of the specified period the purchaser may either surrender his stock, take his escrowed money, with interest, and depart in peace, losing the amount of his first payment, or may retain his stock and let the reserved payment be turned into his company.

As will be seen, there is no protection here. A portion of the purchaser's money is reserved, it is true, and should the company prove a failure, this much is "a brand saved from the burning," but it would seem to be a misnomer to say that a person is protected in an investment because a portion of his money is not invested. In fact, it would seem to be a fraud upon the investor for the whole amount of his money should have gone into the enterprise. At the end of the specified period, if the purchaser retains his stock, the company does, it is true, get this reserved payment with accrued interest—provided the guaranteeing company has not failed or disappeared meanwhile—but at that time it does not need the money. In its hour of trial—its period of development, when every available dollar is needed for the salvation of the enterprise—half or more of the price for which its stock was sold is reserved for a bogus safeguard of the stockholder's interest.

There is something humorous in the idea of protecting a man's investment by reserving a portion of it and putting it out at compound interest for him. It is a fact that it keeps a proportion of his money out of an investment which is too often shaky, and is

therefore so far a real protection. If, however, he is to be protected by a reservation of his money from the investment, he would apparently be much better protected if he refrained in the first place from investing at all. In other words, if the enterprise is a good one, it is only fair to the investor that all his money should be devoted to its development. If it is a bad one, he had better keep out of it entirely. The half-way plan of guaranteed stock is not to his interest in either case.

Up to this point no vital objections have been urged against the system of guaranteed stock and bonds as used in promotion. It does not protect the investor, it is true, but in the absence of misrepresentation the system is hardly to be condemned on this account. Also it deprives the enterprise of part of its development funds, but this is a matter between the promoter, the enterprise and the investor, and to be settled by them. In short, the matter so far is one of those in which, as diagnosed by Lincoln, "If a man likes that kind of thing, that is the kind of thing he does like," and but little can be said against the general scheme if honestly employed.

When, however, we come to consider the character of the guaranteeing companies with which these reserved funds are usually deposited, we do find serious and material objections. If a portion of the investor's money can be safely deposited at compound interest for a term of years for his general benefit, the scheme, though a very circuitous method of saving, may have its advantages. If, however, the guaranteeing company is itself unsound or even lacking in stability,

the whole system becomes vicious and wholly to be condemned. In perhaps most cases the character of the guaranteeing companies leaves much to be desired.

There is no reason that established and well-known trust companies should not handle this business if it is straight and properly managed in all its details. As a matter of fact—possibly because these requisites do not always exist, and because of the general “wild cat” atmosphere of the schemes in which the system is so often employed—the well-known trust companies will but seldom handle matters of the kind, and this has led to the organization of companies for the special purpose of holding the reserved funds that are the basis of the guarantee. Nothing could be said against these companies if they were organized in good faith and on a sufficiently substantial basis, but in the majority of cases it is much to be feared that they are not so organized, nor are they such as a prudent man would select for the deposit of his own money. Add to this the fact that the terms for which these funds are held are usually long ones, ranging anywhere from ten to fifty years, and the danger to the guarantee funds is apparent.

The cost of guaranteeing stocks and bonds by the method discussed varies with the period, with the character of the company making the guaranty, and with the nature of this guaranty. It rises rapidly as the time limit for payment shortens; also, if interest or dividends are included, as the amount of these increases. It also rises with the reliability of the guaranteeing concern or with the solidity of the guaranty.

A few figures from the circulars of a company en-

gaged in the business of guaranteeing stocks and bonds may be of interest. It is to be noted that here, and in most guarantees of the kind, the question that might otherwise arise as to the legality of redeeming stock or paying dividends out of the company's capital is avoided by a modification of the ordinary straight guaranty. The guaranteeing company, when stock is to be guaranteed, instead of undertaking the repayment of the particular share of stock, issues a bond payable to the owner of that stock at the specified date on the surrender of his duly assigned stock certificate. The end to be attained is exactly the same though the method is different. To avoid confusion the bond mechanism, not being an essential feature, is ignored in the discussion which follows, reference being made only to the redemption or guaranteeing of stock.

The prices fixed by this company range as follows, a share of stock of the par value of \$100 being referred to in each case:

A guarantee to pay the full face value of stock at the expiration of ten years without dividends, \$60; at the end of fifteen years, \$47; at the end of twenty-five years, \$31; at the end of fifty years, \$16.

If dividends are also to be paid, the prices range much higher. A guaranty to redeem stock at its full face value in ten years from date of issue, with two per cent. dividend paid annually, will cost \$77; at the end of fifteen years, \$68; at the end of twenty-five years, \$57; at the end of fifty years, \$42.

If a four per cent. dividend is desired the payments are as follows: Full face value of stock payable at

the end of ten years, with four per cent. dividends payable annually, \$95; at the end of fifteen years, \$93; at the end of twenty-five years, \$90; at the end of fifty years, \$80.

It is also to be noted—and the fact is very significant—that these guarantees may themselves be guaranteed if desired. That is, the guaranteeing company will deposit the bonds of some known company of reputation and standing—or even Government bonds, though these come high—with a trust company also of known reputation and standing to secure the payment of its guarantees, but if this is done, the prices are much higher, increasing from twenty to forty per cent., according to the character of the bonds deposited. In other words, if the guarantee is to be absolutely safe a materially higher price must be paid. The inference is direct and obvious that the ordinary guarantee is not absolutely safe and is therefore high at any price.

Guarantees of a nature somewhat similar to those under discussion are occasionally secured by means of paid-up life insurance policies maturing at some fixed date, as twenty or thirty years, the guaranteed securities being redeemed from the proceeds. If the insurance policies are taken out in a reliable company—as is usually the case—this plan has at least the merit of safety for the reserved payments and is an adequate assurance that the guaranty will be paid when due.

It is also to be noted that what may be termed temporary or limited guarantees are frequently secured by the process of reserving the entire amount necessary to meet these guarantees. This procedure

may be entirely legitimate or otherwise according to the nature of the guaranty.

For instance, an issue of bonds is to be sold. The company issuing these bonds is perhaps a new one and the payment of interest for the first few years may be a strain on its resources—perhaps a dangerous one. This possible danger is sometimes avoided by merely deferring the first interest payments on the bonds—as for one or two years—by agreement with the purchasers, so as to throw the whole matter over to a period when the company will presumably be able to meet the obligation. This, however, might have an unfavorable effect on the sale of the bonds and some provision for the actual payment of the interest when due is frequently preferable.

This is easily arranged. As the bonds are sold, a portion of the proceeds sufficient to meet the interest for the desired period is reserved and the interest on the bonds is paid out of this reserve fund until the termination of the period. The fund is deposited with some reputable trust company—usually the company which acts as trustee for the bonds. This company receives a fixed fee for its services, and the whole proceeding is entirely legitimate. The same end would be accomplished by merely selling the bonds at a lower figure with interest not beginning for one or two years, as the case might be, but, as suggested, the effect would in some cases be unfavorable, and the reservation of proceeds is usually to be preferred. The company is deprived of the benefit of the funds so reserved, but the amount is usually not large—the provision rarely extending over two to three years—

and the advantages derived justify the expedient. But little if any publicity is given to this arrangement if adopted. It is not intended for the protection of the investor, but for the protection of the company itself.

A variation of this plan, and a somewhat vicious variation, is found in the practice of guaranteeing dividends on stock in the same way. For instance, some years since a firm of brokers dealing in stock of the Marconi Wireless Telegraph Company advertised that on stock of that company sold by them dividends would be paid for a period of five years at the rate of five per cent. per annum, and that this undertaking was guaranteed by the bond of a highly reputable New York trust company. As the Marconi Wireless Telegraph Company was thought by those familiar with the conditions to be far from the dividend-paying stage, the matter provoked considerable interest.

Investigation showed that the guaranty was secured by depositing with the trust company the full amount of money necessary to pay these five annual five per cent. dividends. The stock was offered at par—and, incidentally, it may be said that a very considerable quantity was sold at this price. For each share sold, \$25, less such amount as would be provided for by the accumulation of interest, was deposited with the trust company and the payment of the stipulated dividend was thereby unquestionably secured.

The purchasers of this “doctored” stock were not, of course, familiar with the actual conditions. They took it for granted that the five per cent. guaranteed dividend was legitimate and was therefore either an

indication of the advanced and prosperous condition of the company and the desirability of its stock, or else that the offered stock was somehow in an inner and preferred circle that gave it a special standing and value. The high reputation of the trust company involved helped out this illusion and the guaranteed stock was sold on the strength of these guaranteed dividends for more than twice its quoted market value. Its purchasers paid over \$50 per share more for their stock than it could be purchased for elsewhere, and the only advantage they derived from this extra cost was the return of \$25 per share in five equal yearly instalments. The whole transaction came dangerously near to a fraud.

It may be said that the trust company involved in this matter protested vigorously against the manner in which its name was being exploited, stating that the company did not in any sense guarantee dividends on the stock in question, and that its only connection with the matter was an undertaking to hold certain funds and to pay therefrom to those purchasing the stock in question five per cent. a year on the face value of that stock for a period of five years. The experience of this trust company will explain the reluctance of responsible institutions to appear in any promotion guarantees of stocks or bonds.

It is to be noted that any guaranty of this kind, if made by the company issuing the stock, would be illegal, as it amounts to a payment of dividends out of the company's capital—a proceeding prohibited in almost every state of the Union. In the instance quoted, however, the guaranty being made by a firm of brokers

who had previously purchased the stock from the company or from other holders, this legal point did not come up. The stock had passed out of the company's hands, belonged to the brokers, and they were at liberty to sell it and to do anything they pleased with the proceeds.

In conclusion it may be said that the whole matter of guaranteeing stocks and bonds as practiced in promotion is a device of somewhat doubtful propriety, intended only to attract investors and without an iota of advantage beyond this. There is no dishonesty involved, though the ethics of the usual and perhaps necessary concealment of the method of the investor's alleged protection might be questioned. Nor if the guaranteeing company is sound and the guaranty is fairly carried out is there much to be said against the system as a whole, provided no misrepresentations are made to the investor. At times it undoubtedly is attractive, and as long as this is the case it will probably continue to be employed. It is to be noted, however, that the system is not now in such common use as it was ten years ago.

A somewhat striking instance of the use of guaranteed stock for directly fraudulent purposes is given in Chapter XXXVIII, "Promoters and Financiers."

CHAPTER XXXVII.

UNDERWRITING.

Underwriting as used in financing is a method of insuring the sale of corporate securities in advance of any public offering.

When a substantial company has been organized and its stock or bonds are to be sold, or when a company already organized issues additional stock, whether preferred or common, or perhaps an offering of bonds, it is not always certain that the securities can be sold at the time to advantage. If offered, the sale may fail in whole or in part and the needed funds not be secured; or the securities may sell, but not readily, and the prestige of the company be injured thereby; or even though the securities sell as rapidly as could be expected, it may require some time for the sale of the entire offering, while funds are needed at once; or the issue may be too large to be offered safely at public sale; or it may be desirable to keep the securities off the market at that particular juncture.

In any of these cases the possible or anticipated dangers are avoided by means of underwriting—that is, for an agreed compensation the sale of the securities is guaranteed by responsible parties, as some bank or trust company, or perhaps a syndicate composed of individuals and institutions financially able.

If the securities are to be offered to the public within a short time, the underwriters enter into an agreement that if such securities are not sold at the public offering, they will themselves purchase them; or if the public take but a portion of the offering, they will purchase the unsold balance.

Or if it is desired to keep the securities off the market in whole or in part at that time, the underwriters may go still further and simply agree to furnish the desired money, and when they have done this will take over the securities and hold them until such time as they can be profitably unloaded.

The advantages of underwriting are manifest. The company that issues the underwritten securities is absolutely assured, no matter what the conditions of the money market, and no matter what reception is accorded its securities, that its money will be available at the agreed date or dates. Also the danger of discredit, or of financial embarrassment from a failure to sell the securities at public offering, is entirely removed. If the securities are offered, but are not purchased by the public, they are quietly taken up by the underwriters, and the company issuing the securities pursues the even tenor of its financed way undisturbed. The cost of the underwriting is usually well justified by the benefits received.

The arrangement is a very common and very convenient one. It is obvious, however, that both the enterprise and the underwriters must be of considerable financial ability and reputation. If the enterprise were of uncertain value or doubtful soundness, no responsible underwriters could be found to insure the

sale of its securities, and on the other hand, if the underwriters were not financially able, their underwriting would be of no effect. The procedure is, therefore, confined exclusively to the realm of sounder finance and is not for the ordinary enterprise. Occasionally, it is true, underwriting is employed in the financing of enterprises of unestablished or doubtful stability, but in these cases it is usually fictitious and indulged in merely for effect.

There are two distinct plans pursued in ordinary underwriting, which, though they are the same in principle, vary in detail. Under the first plan the securities are offered to the public by the company which issues them or by the fiscal agents of this company. The underwriters then merely stand behind the offering, guaranteeing that the stock or other securities will be sold when they are so offered. Sometimes funds will be advanced by the underwriters on agreed terms pending this public offering of the securities.

Under the second plan the underwriters undertake to furnish the desired money to the company issuing the securities at such times and in such amounts as may be agreed. The underwriters then take over and hold the securities until such time as they can be disposed of to advantage. In other words, the underwriters actually purchase the securities.

The method of compensating the underwriters varies with the plan adopted. Under the first arrangement an underwriting price is fixed upon the securities—that is, a price at which the underwriters must purchase if the public do not. A price at which the

securities are to be offered to the public is also made part of the underwriting agreement. The underwriters' price is naturally lower than that at which the securities are offered to the public. If the public buy the securities, the compensation of the underwriters is usually all or a part of the difference between the underwriters' price and the public price, and is paid in cash. The underwriters then receive a substantial compensation for which they have rendered no equivalent beyond the strength of their names. They have merely stood behind the offering, prepared to make good if the public did not.

If, however, the public do not buy, the underwriters must themselves purchase the securities at the lower price agreed upon. In this case the underwriters receive no direct compensation, their profits depending upon their ability to sell the securities at an advanced price later.

For example, suppose a company is organized and issues preferred stock to the par value of \$500,000, which it desires to sell. Its shares are \$100 each and the stock bears a preferred, cumulative dividend of seven per cent. Such a stock in a thoroughly substantial company having satisfactory property values behind its capitalization, should bring its par value. The times, however, might not be favorable, or the company not be in a position to offer the stock advantageously, or other conditions might exist which would render an underwriting advisable.

Such underwriting should be secured without difficulty. The agreement might provide that the stock should be offered to the public on a certain date at

its par value, and if the stock were not purchased in whole or in part by the public, that the underwriters would themselves buy the stock at some lower price, possibly at 95. As a consideration for this undertaking, it might be agreed that the underwriters should receive the difference between their price—\$95 per share—and the price at which the stock actually sold, which in this case would be \$100 per share.

The stock is then offered to the public. If it is all purchased the underwriters are released from their obligation and receive their agreed compensation, which, at the rate of \$5 per share, would amount to \$25,000. As will be seen, the underwriters do nothing whatsoever beyond standing ready to take the stock if the public does not. At the same time the company has been absolutely guaranteed of at least ninety-five per cent. of the par value of the stock, and the underwriters' compensation is probably not excessive. If, however, the underwriting were very safe and attractive, this compensation might be cut down from five to three or even two per cent.

If, on the public offering, none of the stock is sold, or perhaps but a portion of it, the underwriters must then come forward and purchase all unsold stock at their price of ninety-five. This ends the transaction as far as the company is concerned. It has sold its stock at a low price, it is true, but the sale has been effected and it has the money needed for the purposes of the company. On the other hand, the underwriters have made an actual purchase of the stock and they must then rely on a future sale at an advanced price for their profit. They have, it is to be presumed, bought

a good stock at a low price and their profits are postponed, but are not lost.

Where underwriting is conservative, the profits are exceedingly good and the risk negligible. A banker or broker familiar with the conditions, both of the security to be offered and the market upon which it is to be offered, should be able to determine with much accuracy both its real value and its prospects of selling. If it sells, his profits are large and made purely on the strength of a guaranty which he knew was safe. If for any reason the securities do not sell, he is then obliged to purchase them, but if the underwriting is conservative, at a figure that still insures him a substantial profit.

It is obvious that the underwriters—if the underwriting is to be of any effect—must be men of sufficient financial responsibility. It is expected that the securities will be sold when offered, but the whole object of the underwriting is to assure their sale, and if the public will not take the securities, the underwriters must be able to carry out their guarantee and themselves purchase the offered securities. An underwriting by men of this character is an endorsement of the underwritten enterprise of the highest character, and as such in itself aids materially in effecting the public sale of the securities.

The enterprise, then, must be sound and substantial if underwriting is to be secured, and the underwriters must be responsible if it is to be effective. In most cases these conditions obtain. At times, however, through recklessness or misjudgment, one or the other of these requisites is missing and heavy losses

are then likely to ensue. Instances of this were not uncommon in the somewhat inflated financing culminating in 1903, when almost any enterprise having a semblance of solidity could secure underwriting. At that time financiers even of high standing seemed to take it for granted that any colorable issue of stock or bonds could be worked off on the public without regard to its real value, and underwriting was taken on without the usual care and precaution.

The unfortunate shipbuilding trust is a case in point. Coming at the end of the period of "high finance," the public were critical and not in a mood to buy securities of the kind even though good. Securities of the shipbuilding trust could not be called good. The undertaking seems to have been defective either as to the underlying properties or as to the manner of their combination. Whatever the cause, the securities did not command the confidence of the public and did not sell, and the underwriters were forced to purchase at prices that were disastrous—in the case of the Trust Company of the Republic resulting in failure and a final liquidation.

The agreement entered into by the underwriters is usually in the form of a subscription to the underwritten stocks or bonds, the body of the agreement stating in detail the terms and conditions under which the subscriptions are made. The amount of securities underwritten, the price to the underwriters—or syndicate, when the underwriting is taken by a syndicate—the date, price and terms of the public offering, the profits to the underwriters, and the general terms of the underwriting subscriptions, are all important

features of the agreement. It is usually provided that the agreement shall not be effective until some fixed sum has been underwritten.

The underwriters are not usually jointly responsible for the sale of the entire underwritten issue. On the contrary each underwriter subscribes or becomes responsible for some definite amount of the securities, as so many shares of stock or such a number of bonds. This marks the limit of his liability, and in event of profits, determines the proportion of the profits he is to receive. Then, if the public offering or other sale is a total failure, he will be called upon to take the amount of stock or number of bonds called for by his subscription. If but a portion of the securities are purchased by the public, he will be called upon to take his proportion of the unsold securities, and will receive his due proportion of the profits on the securities actually sold. In case the public offering is a complete success, his profits will be determined in the same way.

It is usual in underwritings of this kind to provide that the underwriters may, if they desire, purchase the underwritten securities in whole or in part at the underwriters' price at any time prior to the public offering, or perhaps some earlier specified date. For instance, if some one of the underwriters has underwritten fifty shares of stock at ninety-five, he may, if he wishes, purchase these fifty shares in whole or in part at ninety-five at any time before the public offering, or such other date as may have been fixed. If he exercises his privilege his underwriting participation, both as to liabilities and profits, is reduced by

the number of shares purchased. If he purchased twenty-five shares he is still liable on the underwriting for the remaining twenty-five shares. If he purchased the entire fifty shares, he is out of the underwriting entirely and does not participate further in its profits or its obligations. When an issue of securities is desirable, or particularly when the conditions improve between the time of underwriting and the public offering, this privilege of purchase is often exercised.

If certain amounts of money are needed before the corporation is ready to offer its securities at public sale, as, for instance, for purchase of machinery, or payment for property, or general preliminary expenses or other proper purposes, the underwriting agreement frequently provides for advances by the underwriters. Any amounts so advanced are repaid from the moneys received from public subscription, or if the securities are not disposed of at the public sale, are deducted from the amount to be paid by the underwriters.

Or if the underwriters do not care to advance this money directly, such preliminary amounts are frequently obtained on the security of the underwriting from trust companies or other financial institutions. It is obvious that if the underwriters are of sufficient responsibility to make their underwriting effective, this, in connection with the stocks or bonds and undertaking of the corporation itself, will furnish ample security for any reasonable loans.

The underwritten securities are usually offered to the public through some trust company or other financial institution designated by the underwriting agreement, the institution acting as trustee in the matter.

Or when the underwriting is taken by a syndicate, this syndicate may make the public offering directly or through its own channels. If offered through a trust company such company will apportion the proceeds in accordance with the terms of the agreement, paying over to the company and to the individual underwriters the amount coming to each from the proceeds of the sale. If offered by a syndicate the apportionment among the underwriters will be made within the syndicate, the corporation merely holding the syndicate liable for the net price to be received by it for its securities.

In this latter case the underwriting agreement would probably merely call for a certain net price on the securities, the syndicate being left free to offer them at such advanced price—sometimes within specified limits—as it may deem advisable, the syndicate bearing all expenses of the sale and retaining as its profits all excess secured over the net underwriting price.

The second plan of underwriting, under which the underwriters advance the funds needed by the corporation and take over its securities is, as a matter of fact, a sale of the stock or bonds to the underwriters at such a price as will allow them a later substantial profit. This plan is pursued when the times are not favorable for an immediate offering, or when the offer of so large a mass of securities *en bloc* would produce an unfavorable effect on their sale. Usually the underwriters' price on such securities is such as to make them absolutely assured of a handsome subsequent profit. It is obvious that the issuing institution can afford to make very liberal concessions in order to secure the immediate cash it needs.

Underwriting is quite commonly resorted to in the organization of new and substantial corporations, or when combinations are made, or when generally the conditions make it desirable. Even the strongest corporations employ it. The preferred stock of the United States Steel Corporation was underwritten at the time the company was formed, and again its five per cent. bonds were underwritten a few years later at the time of their issue. Even so strong and well-established a corporation as the Pennsylvania Railroad resorted to underwriting in an issue of stock some years ago. The profits of the underwriters in that instance ran into the hundreds of thousands of dollars, but the company's course was not criticized by the soundest financiers, even though the stock when offered was readily sold. The times were unfavorable, the success of the issue could not be foretold absolutely in advance, and its failure, even in part, would have been most disastrous, involving loss of prestige as well as the failure of the needed funds. The price paid to avoid these disquieting possibilities was not excessive.

CHAPTER XXXVIII.

“PROMOTERS” AND “FINANCIERS.”

A successful promoter must possess sound judgment, much business experience, wide connections, and more or less persuasive and magnetic personality. In addition, he must ordinarily be capable, honest according to the circles in which he moves, and of good reputation. Such men do exist in all our large cities, but the man with an enterprise will have much difficulty in finding them, and, when found, in enlisting their services.

Theoretically a man of this kind, devoting his attention to promoting, would take up an attractive and meritorious enterprise, organize it with a reasonable capitalization and a well devised plan of operation, reserve a substantial stock interest for himself and those associated with him in the enterprise, and sell enough of the remaining stock—as he could easily do—to provide ample capital for development and operation. The financed enterprise would then be placed in the hands of competent managers and while it was booming along the royal road to success, the promoter would take up and finance the next good enterprise in the same way. By repeating this performance he would with ease and rapidity accumulate wealth far beyond the ordinary dreams of avarice, until accumu-

lation itself became a weariness and he turned for relaxation and amusement to moral discourses and the founding of libraries.

There are men who, so far as their personal part is concerned, are capable of carrying out this program to the letter. Indeed, some of the large exploration companies—which are really exploitation companies—are practically doing this very thing. The reason that it is not more frequently done is found mainly, if not entirely, in two facts—one, that the promoter's profits almost always depend upon the final commercial success of his enterprise, and the other, that it is almost impossible for him to find assistants who are capable of carrying on his enterprise to this required success.

In some of the combinations and trusts formed within the past decade the promoter's profits have been in cash or "cashable" securities, because the undertaking was based on going concerns. When this is not the case the promoter sometimes stipulates for a commission on the money secured, when any profits are again immediate. Usually, however, the promoter's profits are "paper" profits to be converted into something more substantial by the development and operation of the enterprise. In other words, while the promoter's work in financing enterprises is of prime importance and an essential preliminary to success, and while his profits on these enterprises are nominally enormous, they are also—and properly—mainly in the securities of the companies he has formed and are therefore dependent for their value upon the success of the respective undertakings. The promoter

cannot therefore—or should not—profit largely until the enterprise has attained industrial success.

In practice, then, when the really capable men we have been considering devote themselves to promoting, their enterprises are usually financed with considerable ease, money being secured quite as much on the reputation and known ability of the promoters as on the actual merits of the enterprises. Then, however, their profits must usually be worked out, and unless this task can be delegated to others, it occupies the larger portion of the promoter's time and attention.

It is almost impossible for the promoter to shift the burden of this development to other shoulders. Men who can carry on large enterprises to commercial success, except under the closest supervision, are almost as scarce as successful promoters. They are also difficult of discovery and much in demand. The subsequent operations of the financed enterprises are therefore usually thrown directly and unavoidably upon the promoter. Then, two or three good big enterprises taken up and financed will so occupy the promoter's time and attention that he is completely "balled up" and cannot if he would take up further promoting propositions.

It is no unusual thing for a successful promoter to reap returns from the financing of a large enterprise—in its stock or other securities—up into the hundreds of thousands and even millions of dollars. With such excessive profits waiting to be worked out and with his reputation also at stake, it is no wonder that the promoter, now a financier, is in no mood for new undertakings.

The same thing occurs on a smaller and more modest scale with men of less ability in financing. They work for a time in promoting enterprises for others, but if they possess any real ability in their particular line, quickly become men of "affairs" and those affairs their own, and they are then no longer in the field as promoters.

It is true, of course, in all these cases that a time usually comes when the successful promoter will have carried and matured the undertakings in which he is interested so far that he can leave them largely, if not entirely, in the hands of subordinates. Then, not being fully occupied with the matters in hand, he is ready for new enterprises. If something unusually attractive presents itself at this juncture, he will take it up and carry it through. This, then, is the opportunity for the man with the enterprise to secure the services of a first-class promoter.

From this brief consideration of the subject it is easily seen why promoters and promoting concerns of real merit but seldom figure openly in that capacity. They undoubtedly do exist in reasonable numbers, but their work is mainly or entirely of a private nature. They take up enterprises and promote them, but these enterprises become and are known as their own.

As a matter of fact there is a conspicuous absence of reputable men or concerns publicly engaged in the business of "promoting" or "financing" enterprises—that is, concerns or individuals whose occupation is taking up and promoting enterprises for the owners. There are, it is true, numbers of concerns and individuals advertising to finance enterprises and secure

capital. They undoubtedly do secure capital, or they could not continue to exist, but from the writer's observation and the extended experience of others, it would seem that the capital they secure is almost entirely from and not for their clients.

It is obvious that something must be wrong with either man or concern posing as a public promoter and ready at any and all times to take any and all enterprises and carry them through to financial success. Concerns and individuals willing and anxious to undertake all this do exist and are not hard to find, but, speaking generally, they do not "make good." The very fact that they advertise their ability and willingness to secure capital for enterprises is enough to stamp their claims as false. A few successful "financings" would alone be sufficient, without any other advertising, to bring them all the enterprises to be financed that they could possibly desire. The chief difficulty of concerns that really finance enterprises is to escape the importunities of those who wish to bring them business of the kind. They do not dream of advertising for enterprises to finance.

The advertisements of the concerns and individuals of the public-promoter type usually read much alike: "Capital secured for meritorious enterprises." "Companies incorporated, stocks and bonds sold and enterprises financed." "Inventors or others desiring additional capital should see us." "We represent several private bankers, trust companies and individual capitalists," etc., etc.

If application is made to these advertisers, the general result is about the same. The concern appealed

to is more or less enthusiastic about the particular enterprise, is quite sure that the required money can be secured; has perhaps been looking for something of just that kind; will possibly have somebody in mind who wishes to invest in an enterprise of the kind, and about this juncture, when the applicant is feeling cheerfully confident that his troubles are over, and is congratulating himself upon the very capable hands into which he has fallen, a demand for an advance payment of money will be made.

The basis of this demand will vary with the conditions. Incorporation or re-incorporation of the enterprise furnishes a favorite pretext. It is obvious that stock or other corporate securities cannot be sold if they do not exist, and if the enterprise is not incorporated, the demand is not in itself unreasonable. The main objection then lies in the fact that the promoting concern, while highly gifted in the matter of charging for its services, is not qualified to do the work. The incorporations effected by such concerns are almost always defective; in many cases are absolutely worthless and in some cases are even worse, so tangling up the affairs of the undertakings as to involve much expense and trouble in merely undoing the work already done. An excessive fee is charged for these worthless incorporations and their stock is not, as a rule, sold. The client therefore finds that he has expended more money than necessary, has secured an incorporation of doubtful status or no status at all, and that his securities are still unsold and usually not in shape to be salable.

If the enterprise is already incorporated, a re-in-

corporation on different lines, but still involving liberal fees, will be suggested by these "financing" concerns; or perhaps their financial experts will decide that an issue of preferred stock or of bonds is desirable, and will demand money for the legal work involved and for the preparation of the stock certificates or bonds. Or if these demands are not sufficiently plausible to carry, they will perhaps suggest a guaranty of the stock or bonds they are supposed to sell, or will ask for money to advertise the securities for sale, or they may find it necessary to have a prospectus printed, or they may decide that additional or foreign patents are necessary. Sometimes without evasion of any kind they will demand money as a direct retainer.

The following letter from a concern of this kind is copied verbatim from one received by a friend of the author, the names only being changed. It was received in response to an inquiry as to whether the concern could assist in financing an invention owned by the gentleman writing. It may be said in passing that this invention was in such an undeveloped state and so far from any condition in which it could be financed by the sale of stock or bonds, that the matter would not have been contemplated seriously by any responsible house. The letter is so characteristic that no apology is needed for its insertion.

MR. JOHN CORLISS,
Camden, New Jersey.

Dear Sir:

Your letter of the 22d inst. duly to hand and contents fully noted. We are not in a position to do any-

thing to assist you in promoting this enterprise until your Company is incorporated, as we handle nothing but stock, and this before we could put it on the market would be required to be guaranteed by the Banking Company who do our business.

If you should desire it, we can incorporate a Company for you under some of the western states at a nominal cost, which would answer all your requirements so far as the Charter is concerned, and if you could give us full particulars as to the amount of capital you are thinking of incorporating for, we could give you the cost of the Charter and possibly stand in with you on the expense of getting same.

Should be glad to hear from you at your convenience.

Yours truly,

WELLMAN-PHILLIPS Co.

It will be noticed that this letter covers several points of possible profit to the promoting concern. In the first place the enterprise must be incorporated, and it is a fair presumption that substantial fees would have been demanded for this service if the applicant had pursued the matter further. In order, however, to make it easier and more attractive for the possible client, the promoting concern intimates that it can possibly share the expense. Such offers are very common in the realm of "fake" promotion. It merely means that the promoting concern, instead of taking its full fees in cash, would be willing to take part in cash and the balance in stock of the enterprise. As the portion of the fees paid in cash is usually sufficient not only to cover the expense of the work

but leave the promoting concern a profit, the offer is a very safe one and particularly so as it is to lead to further "business."

After the incorporation of the company its securities must be guaranteed, according to our letter, and here comes in another source of possible profit to the promoting concern. This guaranty must be made "by the Banking Company who do our business." The guaranteeing company in such cases will usually require a substantial retaining or first fee in advance, and it is more than a presumption that in most cases of the kind the promoting concern and the guaranteeing company work together and divide this first fee. Then, even if the matter goes no further, both these parties have received excellent payment for the work they have not done.

After the incorporation has been effected and the guaranty of the corporate securities has been obtained, the sale of these securities is still to be considered. Here again the promoting concern has an opportunity to bleed the applicant—an opportunity which is never neglected. Money will be required for a prospectus or advertising, or expense money, or some other of the many schemes devised by the fertile imaginations of the promoting concern. If the applicant accedes to these demands, other demands are apt to follow, until he becomes weary of parting with his substance and brings the matter to a close. As a net result the promoting concern has pocketed a substantial amount of the applicant's money and the applicant has nothing to show for it beyond some experience, which, it is to be hoped, is of value, and an incorporation which is usually of no value whatsoever.

Most of the demands made by these concerns would be entirely proper and not to be objected to if they really led to the sale of the securities and the general financing of the enterprise. As a matter of fact, however, it is but rarely, if ever, that any results are secured, and the demands for money made by these concerns are made with the full knowledge that their client will advantage little or nothing. Such procedure may not be a fraud from the legal standpoint, but comes as close to it as is safe for the promoting concern. Occasionally it comes closer. Several such concerns in New York City have received advertising not desired by their publicity departments through police raids and proceedings in the criminal courts.

Undoubtedly the concerns in question would, if they could, sell their clients' securities. They usually do something in return for the benefits received. If they demand money for advertising, at least a portion of this money will usually be expended in advertising. Also, if without too much trouble and expense they can do anything to finance the enterprise, they are generally willing to make the attempt. It is even possible—though as to this the author has no personal knowledge—that enterprises are sometimes financed through these concerns.

As a rule, however, the only money obtained by these concerns is that taken from their clients, the amount they secure depending entirely on the willingness and ability of their clients to "give up." In one instance within the writer's knowledge over \$1,000 in cash was paid a concern of this kind to cover the expense of a bond issue. This was done on the state-

ment that the bonds could undoubtedly be sold if they were once properly issued. The concern did not, however, state that it would sell the bonds, or obligate itself in any way, and the consequence was that the concern got its money, the client got some valuable experience and some cheaply engraved bonds, but the bonds were not and are not sold. This same concern openly announced in its printed matter that "No application will be considered unless a check for \$250 is deposited with us at the time of sending in the application." It is gratifying to state that the career of this particular institution was brought to a sudden and deserved conclusion by the efforts of the police, assisted by a capacious patrol wagon.

In most cases, however, transactions of the kind are not conducted on so lofty a basis. Even in the case of the concern mentioned, there is a suspicion that a less amount than \$250 would have enlisted its attention and sympathies if the prescribed amount was not forthcoming. In most cases no limit of any kind exists, the only practical limitation being the amount obtainable from the client. Handsome fees are always desired and requested, but if these cannot be extracted from unwilling or "unable" clients, the usual promoting concern is not disposed to be critical, but will take what he has even though it be but a few dollars.

In this connection a quotation from ex-Postmaster General Cortelyou as reported in the *New York Times* is in point. This is in explanation of the fraud practiced some years since by the Imperial Trustee Company of New Jersey, acting in collusion with brokers and promoting concerns who professed to secure capi-

tal for enterprises. The situation outlined is very characteristic, though it must be said that in the present instance the whole arrangement seems to have been a fraud without mitigation, whereas in most of the "capital-securing" concerns nothing openly fraudulent obtains—anything that would give a basis for either civil or criminal proceedings being carefully avoided.

"The company advertised to act as trustee under corporate mortgages and deeds of trust, and as registrar and transfer agent of corporations and corporate securities; to execute trusts of all kinds, to guarantee corporate and other securities, to incorporate and reorganize companies in any State, to act as accountant, to furnish a registered office for New Jersey corporations and a safety deposit vault for clients.

. "It was in the guaranteeing of corporate and other securities that the schemers made their money. * * * Colt, and other brokers, agents of the Imperial, would advertise broadcast that they had money to invest in bonds for clients. The amount awaiting investment would be variously given—sometimes running into the hundreds of thousands. Often a preference was stated in the advertisements for the securities of newly organized concerns, those of an industrial nature particularly.

"When the man with bonds to sell visited the broker who had money to invest he would invariably be met with the statement that the securities would have to be guaranteed, and the suggestion would be made that the Imperial Trustee Company was the institution from which a guarantee would be most certain to insure results.

"The Imperial Trustee Company was ever ready to underwrite the securities and would insist that a certain amount of the proceeds of their sale be deposited with it to provide for their redemption at the expiration of the time for which they were to run. This was thoroughly business-like and no objection could be made. Impressed with the idea that there were customers waiting only for the guarantee, the customers usually put up the money demanded as a fee and turned over the bonds to the brokers, who undertook to dispose of them. In some instances the fees amounted to thousands.

"This would end the transactions, so far as results were concerned. In all my investigations I have not learned of a single bond being disposed of through a broker working with the Trustee Company. Finally the victim would realize that he had been defrauded, but in the great majority of cases he would go no further than to demand the return of the securities. In the meantime the company's brokers would be seeking other investors."

The postal authorities undoubtedly did have a very clear perception of the manner in which this and similar frauds are worked. The only regret is that the exposure was not made sooner. The amount secured by the Imperial Trustee Company from its fraudulent transactions was far up in the hundreds of thousands of dollars.

Another expression of expert opinion relating particularly to the sale and financing of patents may be of interest as showing the operations of the "system" in this field. The quotation is from the printed matter

of a firm of patent attorneys. Its statements are intended to warn the clients, or prospective clients of the firm, from the snares that are more thickly spread in the path of the inventor than is the case in almost any other line of financing.

"Inventors, as soon as they receive their patents, or a very short time after, will be beset, importuned and harassed by offers, propositions, requests and solicitations of all kinds and descriptions, coming from firms, persons and companies, not only in this country, but also in foreign countries. * * * These propositions will be very attractive and temptingly prepared, and will vary with the ingenuity of their authors. Some will pretend to want to purchase inventions outright, others to place them on royalty, and still others to sell on commission, enclosing contracts drawn up in an impressive way. All of these propositions, although apparently different, will have one point in common; they require the payment of a cash fee in advance. One will say that it is necessary to have money to advertise the patent, another the cost of having circulars printed, and another the cost of securing copies of the patent for distribution, and so on. There is no end to these pretexts. We are often asked by inventors if these parties who so plausibly claim to be able to sell patents are reliable, and whether they ever effect sales. We regret to be obliged to say that, in many instances, they are unreliable, and we are unable to learn of their making any sales. Our advice is to ignore these offers entirely, as agents of this class have no facilities for selling patents, and aim only to collect money for which they can

give no return. A favorite scheme with these parties is to solicit foreign patent business, representing that they have extraordinary facilities for selling the foreign patent rights, and even going so far as to set a price which the foreign patent should bring (such price being fixed at an attractive figure). They state, however, that they will only dispose of the inventions of persons applying for patents through them. It is best to have nothing to do with these persons, as this is a very old device to secure foreign patent business, for they have neither the facilities nor the intention to dispose of your patents, but simply make these offers as a bait to obtain your foreign patent business. We would advise inventors to beware of those attorneys who offer to transact their foreign business at rates very much below those charged by reputable attorneys. These attorneys will subsequently make extra charges for amendments, etc., and if you refuse to submit to the extortion they will decline to prosecute your cases further."

The demands for money made by these "capital-securing" concerns are sometimes very plausible. In a case in mind an inventor was approached with the suggestion that foreign patents on an invention of his would be exceedingly profitable and that the concern communicating with him would be glad to undertake their sale. Of course the patents must be secured before they could be sold, but the managers of the accommodating capital-securing concern were so favorably impressed with the merits of the invention and the profits that might be obtained therefrom, that they were willing to help the inventor get the foreign

patents, and for a suitable interest in these patents would put up a full one-half of the total cost. Investigation showed that the fees charged by this house were something over twice what the patents could be secured for through other channels. Hence, the promoting concern was entirely safe of at least a moderate profit on its proposition. It is not unreasonable to suppose that it would have made further demands and further profits out of the transaction had its first offer been accepted.

Instances of the exactions of these concerns might be multiplied indefinitely. It is, however, entirely sufficient to lay down the general rule that in New York—and presumably in the other large cities of the country—no matter what the pretext, nor how alluring the ends to be attained, any advance payment demanded by a promoting concern should be regarded as a danger signal warning the applicant off. Reputable houses do not make demands of the kind, and it is but inviting loss and disappointment to devote time to negotiating with a concern that does.

It is possible, of course, that there may be institutions of the kind conducting legitimate businesses and even asking advance payments from their clients, but, if so, their number is too few to affect the general rule, and their whereabouts is unknown to the writer.

When we come to individuals, as has been said in an earlier chapter, promoters may be found who really promote, but to discover them is apt to be a matter of considerable difficulty. They do not either advertise or even call themselves promoters. Their promoting is of a semi-private nature, and in perhaps the

majority of cases, in connection with their regular business. They are not professional promoters and are not to any extent in the public eye.

The real professional promoters of the larger cities are the unsuccessful ones. Most of these have drifted into promotion because thrown out of their accustomed channels, or perhaps they have been "drifted out" by unfortunate enterprises which they undertook to finance and which have gradually absorbed their time, money and attention to the loss of all other business.

The majority of these promoters are elderly men; in many cases men who have been in business and successful business, but have for one reason or another lost their money and their business standing and have taken up promoting as a forlorn hope. Once in the toils they rarely escape, but go on year after year, eking out existence as best they may and looking forward to some happy stroke of promotion luck that will put them on "easy street."

It is but rarely that these professional promoters accomplish any financing of importance, and they live by borrowing, by an occasional small commission, by payments for introductions, by advances from credulous clients and by other receipts of uncertain nature. They are usually seedy, almost invariably in financial straits, and always cheerfully ready to take on new business.

Many of these promoters have good connections, and they will explain at length just whom they are related to, what prominent business men they are acquainted with, or have had dealings with, and will give details to show their familiar relations with the parties

mentioned. In most of these cases the statements are largely, if not wholly true, but unfortunately the promoters have no standing with these friends or connections that affords a basis for the transaction of business. Usually an introduction from one of them is of but little value. At times it is of positive disadvantage. In other words, in such cases the party with an enterprise might better appear before the promoter's friends as a perfect stranger than to be introduced—and thereby discredited—by the promoter himself.

It is easily seen that the class of business that would usually come to these promoters is not of the highest. A good enterprise could only come through their hands by accident. For this reason the mere fact of an enterprise being in their hands is sufficient to cast suspicion upon it.

These promoters are always ready for new business of any kind, and demand a handsome interest, commission or percentage for their services, but are usually willing to make large concessions if necessary. In any case, they are quick to see an opportunity to secure an advance, or expense money, or any other contribution from their client. They usually demand contracts, are always ready to tie their victims up indefinitely if they can, and when they do secure an enterprise to promote, distribute prospectuses as freely as the cost of these prospectuses will permit, pass the enterprise along to all their confreres of the promoting clan, and "hawk" it generally and widely. It is discredited by the mere fact of their presentation. Occasionally, of course, such promoters do get hold of a good enter-

prise and succeed in interesting other promoters of more influence, or even reach men with money, but as a rule the man with the enterprise had better give them a wide berth.

Another related class of promoters are those engaged to a greater or less extent in the gold brick industry. These promoters or brokers are of a financial standing usually a little better than those described though their moral standing is a little worse. These men find it difficult to "lie up to the truth" when describing their enterprises, and their first rule of action is to get money—honestly if they can. These men usually have a very clear perception of the real merits of the enterprises which they undertake. They prefer, however, the easier promotion of a fraudulent or semi-fraudulent enterprise, with its ready returns from a people that "like to be humbugged," to the slower and more hardly earned returns of a sounder undertaking—if, indeed, they could finance such an undertaking.

It is obvious that a mining proposition costing but a few thousand dollars, remote from investigation, capitalized at some millions of dollars and with the hopes or imaginations of the promoters supplying the "facts" for its presentation, can offer attractions that no honest undertaking can. Also, as a matter of practice, it will secure money with an ease and abundance—so long as the public continue to exemplify the old proverb in regard to a fool and his money—that cannot be equalled by the most meritorious of honest enterprises.

The men who promote these schemes depend for

their continued success upon the very large number of people to whom they can appeal, and are aided by the aversion of the ordinary man to mention the fact of his having been worsted in an investment. If their present clients are defrauded—or to put it more elegantly, if their investments turn out “unfortunately”—the broker or promoter in the case esteems the matter of minor importance so long as it is not made public, or if it is made public, so long as his name is not connected therewith. There are plenty of fresh victims to prey upon, and with these the previous history of the promoter is not prejudicial because unknown. When it does become generally known the promoter changes his name, and freed thereby from the dead weight of his well-earned reputation, and carrying with him a full equipment of loaded dice, he starts afresh elsewhere in the battle of life.

Another class constantly verging on the edge of misrepresentation and not infrequently passing over on the other side, is composed of impecunious owners or promoters of enterprises yet to be financed. In many cases these men have brought their enterprises to the existing condition by material sacrifices, and in almost every case they feel that their entire future depends upon their success in this particular undertaking. Often they are relying upon the money obtained from their “deals” for actual living expenses. Add to this the fact that generally and naturally their enterprises are either in bad condition, impractical, worthless or held by uncertain tenure, and the difficulties of their position are apparent. Money must be had. It is needed not only in their businesses, but

to obtain the necessities of life for themselves and perhaps those depending upon them. Believing as they usually do to the utmost in the value and future profits of their undertakings, these promoters feel that if they can get money in any way, even though the bounds of prudence or honesty be overstepped, they are right in so doing; that the ends to be attained amply justify the means, and that in the final "round-up," their victims will be glad they were brought in, even though the representations that secured them verged on misrepresentation, because of the great wealth that will then be theirs. Promoters of this kind are usually willing to assist in promoting the enterprises of others. They are always on the lookout for funds. As a class they are not to be taken seriously, but considerable caution is advisable in dealing with the individual.

CHAPTER XXXIX.

COMMISSIONS AND BONUSES.

When financing an enterprise the owner may be called upon to pay commissions or compensation for services rendered, as follows :

- (1) To parties who effect a sale, when the matter is one involving a sale.
- (2) To parties who directly secure money for the enterprise, whether by sale of stock or other securities, or by the sale of an interest in the enterprise.
- (3) To parties who interest other parties, these other parties bringing money into the enterprise.
- (4) To parties who give introductions leading directly or indirectly to money.

Commissions under the first head—that is, to parties who make a sale of the subject matter of the enterprise, as an invention, mine, etc.—are simple. Such a transaction is usually clean-cut and a fair commission is easily determined, although there is no absolute rule. A sale of real estate in New York City carries a commission of one per cent. in the absence of other agreement. Five per cent. is supposed

to be the proper commission for the sale of a mine. For general offerings there is no understood amount, the matter being a subject of special agreement in each case.

Under the second head, where the parties sell stock or bonds or an interest in an enterprise, the conditions are more difficult, but the matter is still usually clean-cut and the commission or compensation paid the broker or promoter is not difficult of arrangement. This is usually a percentage of the money secured, or perhaps some stock interest ranging from five to twenty-five per cent. or even more. Or sometimes a certain amount of stock will be given the agent or promoter in payment for his services, this amount having no relation to the cash secured, or at times the owner of the enterprise will turn over a block of stock to the promoter with which to raise the needed funds, leaving the promoter to save what he can out of this stock for himself.

Under the third head, where parties interest others, these latter securing the money for the enterprise, the conditions are apt to be harder. The immediate parties do nothing beyond interesting others who may perhaps secure the needed money from still other parties. If, however, the money comes in, the first parties who occupy the position of "connecting links" are entitled to a fair payment, the amount of which should be agreed upon in advance and which is sometimes difficult of estimation. If, however, the money comes only in part, or comes in conditionally, the matter may become complicated, and still more so when, as sometimes happens, the matter passes through the

hands of two or three parties before the actual investor is reached, each of these parties demanding payment for his services.

In a recently decided case this very point came up. A Boston broker was appealed to for money to develop a mine. He agreed to undertake the matter on condition that he receive a commission of ten per cent. if he secured the money, either directly or indirectly. Not being able to raise the money himself, he introduced his client to a New York broker, who also made a commission agreement with the owner of the mine. The New York broker in his turn failed to get the money directly, so introduced the mine owner to a third party. This third party also made a contract for compensation with the long-suffering mine owner and then got the money. The Boston broker was supposed to have been eliminated by this time, but hearing that the enterprise was financed, he promptly brought suit for his commission and won his case in the lower courts, only failing to collect because the whole enterprise went to pieces.

Commissions under the fourth head—for introductions—frequently strike those unfamiliar with the practice as peculiar and uncalled for. Under ordinary circumstances, and particularly in the smaller towns and cities, if a man cannot or will not put money into an offered enterprise himself, but thinks a friend or an acquaintance may be disposed to do so, he will introduce the owner of the enterprise to this friend or acquaintance as a matter of course and of courtesy, without expectation of profit. In the larger cities, however, and especially in financial circles, an “un-

paid" introduction leading to money would be regarded as an amazing and inexcusable disregard of the proprieties of business.

The practice is not without justification. In financial circles a man regards his moneyed friends and connections as part of his capital. If he needs money for a good enterprise he can probably get it from them. Their capacity is, however, limited. If then, he "taps" these money reserves by introducing a friend or a business acquaintance with an enterprise to finance, he looks upon the proceeding as in effect parting with a portion of his capital and demands payment accordingly.

Or from another standpoint, he may look on it that he cannot help the man with the enterprise directly, but he can indirectly, and that he is just as clearly entitled to payment for this partial assistance as if he did the whole thing—not to so much, perhaps, but still to a substantial compensation. Be the ethics what they may, the fact remains that in promoting and financing circles a commission or payment is expected for introductions made for the purpose of securing money, when money is secured thereby, and further it may be said that this payment can be exacted by legal proceedings unless it is clearly understood that no such obligation is incurred by the party introduced.

There is no rule or custom as to the amount of such a commission. Usually an agreement will be made that a commission is to be paid if money is secured, this commission either being a percentage or some fixed sum. In one case the owner of some valuable oil properties paid several thousand dollars in

cash for such an introduction, the payment being due as soon as the introduction was made, without regard to results. Such an arrangement is not, of course, usual.

When arranging for an introduction of the kind, care should be taken that the liabilities for commissions extend only to money secured for the matter in hand. Otherwise the introducer may claim a commission on further business transacted between the introduced parties for an indefinite length of time. In the absence of an express agreement to that effect, such a continuing claim could not ordinarily be enforced, but trouble may be saved by a distinct understanding that commissions are only to be due on the one particular transaction.

As to the amount of commissions in general no fixed rules exist. It will depend largely on the conditions. If a man has a first-class enterprise, attractive in nature and in good shape, and particularly if he is not harassed by personal financial necessities, or the necessities of the enterprise, he will have to pay a fair commission, but not at all an excessive one. His commission payment then would probably range from five to ten per cent. of the amount secured, or perhaps some lump amount in securities of the enterprise would be agreed upon. If the enterprise is not quite so meritorious, or the financial condition of the owner is not so good, the commission rate will run higher; probably from ten to twenty-five per cent. With a doubtful enterprise or a desperate need of finance, the commission demanded will run up to an indefinite percentage.

The matter is also frequently complicated by changes in the terms on which funds are obtained. It is but seldom that money for an enterprise is obtained on the proposition first made, especially where the conditions of the enterprise are not of the best. The men with money are usually good business men and have very clear ideas as to the merits of a proposition, and if it is not in the best shape or not in the shape that suits them, have no hesitation in suggesting changes. Usually the man with an enterprise will find it of advantage to meet any reasonable demands and then if commissions have been arranged on the basis of the original proposition, without some provision for changes therein, a fair adjustment of the matter may be very difficult.

Frequently when dealing with a promoter, the owner will name his best terms, or as otherwise expressed, will fix a flat price for the interest offered and then let the promoter raise the necessary money and save or make as much for himself as he can—perhaps within fixed limits. For instance, the owner of an enterprise may be willing to give a half interest for the money he requires, the amount being stipulated. He turns the whole matter over to his promoter under an agreement to deliver fifty per cent. of the enterprise as a consideration for the designated amount, expressly stipulating that he shall not be liable for any commissions or for any expenses incurred by the promoter in his work. This does not provide any specific commission for the promoter, who must then make his profits the best way he can.

If the enterprise is a desirable one, and the promo-

ter a man of fair ability, he may perhaps induce the parties with whom he is working to allow him some payment for his services. In the ordinary enterprise this is, however, a somewhat difficult matter, as the man with the money is almost sure to demand at least fifty per cent. of the undertaking in return for the money he invests, and is not inclined to give any of it to the promoter. Ordinarily, therefore, the promoter cannot look to the purchaser for a commission, and he would then probably increase or "load" the price of the half interest before offering it for sale, with the expectation of retaining the excess amount as his compensation. This practice is common and is not open to objection—legal or otherwise—provided that the increase is reasonable in amount and that the promoter appears in the matter as the agent of the owner.

To guard against excessive loading when a "flat" price is given, the owner should fix some maximum figure above which the broker or promoter may not go. Theoretically the promoter would himself stop at a reasonable price, but in practice he does not do this, frequently loading so heavily that success is impossible. Some price limitation is therefore very desirable.

When the services of a broker or promoter are retained, a written commission agreement is customary and very desirable. This may be as formal or informal as desired, provided it is clear. A proposition in ordinary letter form, addressed to the promoter and making him a direct offer will, when accepted by him, be quite as effective and binding as the most formal contract.

The details of the agreement should, however, no matter what its general form, be expressed with absolute clearness. Usually the agreement will, if of any importance, be drawn by the attorneys of the interested parties, but in any case these parties should see that the important points which follow are properly and clearly covered.

(1) The agreement should designate specifically the enterprise covered by its terms. Also the general plan or proposition on which it is to be financed should be stated broadly at least. This should be done for the sake of clearness and to aid in the interpretation of the contract provisions.

(2) The agreement should be confined to the immediate issue—that is, it should apply clearly and unmistakably to the one enterprise then in hand, and to work performed in connection with that enterprise and in accordance with the terms agreed upon. Frequently a commission agreement will be so vague in its terms as to raise the question whether it does not also include other undertakings which the owner of the enterprise may perhaps be financing then or take up later.

(3) The agreement should be clearly defined as to scope. Frequently a promotion contract for patent or other rights, intended to apply only to the United States, will be so loosely drawn that the promoter can claim to control foreign rights as well. If the agreement is intended to apply only to the United States or to some portion of it, or if otherwise, the conditions should be clearly stated.

(4) The agreement should be limited as to time,

particularly when the rights granted are exclusive. Usually a promoter—and not improperly—will demand an exclusive control of some kind, but if so the time at which such control will terminate should be definitely fixed. If this is not done, the promoter may be unable to finance the enterprise promptly, or will perhaps not push the matter at all, and then when the owner becomes impatient or finds other opportunities to get the money he needs, the whole thing may be held up by the promoter until he is paid for its release. Also, if the promoter will consent, it is wise to provide some means of terminating the agreement before the specified time should the owner find other channels of financing, provided, of course, that no binding obligations have been entered into at that time by the promoter. In such case the promoter would probably—and properly—require that some proportion of his commission should be paid as compensation for his trouble in the matter.

(5) The agreement should make provision for any partial fulfilment of its terms. The promoter may secure but a portion of the required money within the specified time. It should therefore be provided that the owner is at liberty either to accept or reject these partial subscriptions. In case of acceptance the promoter would of course have a *pro rata* commission on the amounts actually obtained.

(6) The agreement should provide for any modification or readjustment of the original plan. As already stated, it is but seldom that an enterprise is financed along the lines first laid down, and some flexibility in this respect in the commission agreement

is therefore desirable. Without it the owner may in the course of the negotiations have an advantageous proposition on a modified basis, but be unable to accept it on account of the rigid terms of the commission agreement—that is, the promoter may then have it in his power to hold up the whole matter until terms, satisfactory to him, are agreed upon, or until his full commissions have been paid.

To cover this point the agreement might provide that in case of any change in the proposition the commissions shall be settled by reference to a third party if the principals cannot agree.

(7) The agreement should state with precision the commissions that are to be paid and whether these commissions are payable in cash or in securities. If the latter, the securities intended should be clearly designated.

(8) The agreement should specify whether the commissions are payable on the net amount secured or on the gross amount before deductions are made for expenses. If not otherwise specified, the commission would be payable on the gross amount.

(9) The agreement should state when and how commissions are payable. Unless otherwise stipulated, commissions are payable as soon as the owner of the enterprise reaches a definite agreement with the parties who are to invest. Then, perhaps before the owner has received any money, the promoter may legally claim and enforce payment of his commission. To provide against this the commission agreement should state that commissions are payable only when and as payments are received by the owner of the en-

terprise. If a part of the commission is payable in securities, the time of delivery for these securities should be clearly stated.

(10) If the promoter is himself to pay the expenses of his effort to secure money, it is advisable that this be specified in the contract. The promoter might not be able to substantiate a claim for expense payments even without specification, but to avoid trouble the matter should be clearly stated.

The bonus differs from the commission. A commission is a payment for services rendered; a bonus is something in addition to this payment, or, speaking generally, it is a donation or gift given as an inducement for the accomplishment of some special end. For instance, the owner of the enterprise may enter into a commission agreement with a promoter in which the amounts of commission are specified. The owner may then offer a bonus in addition to this commission if the promoter will complete the matter within a specified time. Or if bonds are to be sold, a certain amount of stock is frequently given as a bonus. In this case the bonds are offered at a certain price and the stock is thrown in without direct consideration, as an additional inducement for the purchase of the bonds. Or sometimes a bonus or gift of stock will be given to some influential party merely to secure the use of his name, perhaps as a director or possibly merely as a stockholder. It is also quite common to give a bonus of common stock when preferred stock is offered for sale, especially if the preferred stock does not carry the right to vote. At other times cash bonuses are employed on the same general lines.

Bonuses of the kinds discussed are common and are frequently employed to much advantage. At times they add materially to the attractiveness of corporate offerings, and are used in other matters to good effect. Within the knowledge of the writer a bonus of \$5,000 in cash was paid a prominent firm of attorneys to allow their names to appear as counsel of a certain enterprise. In addition to this substantial payment the attorneys received their regular fees for all the work done by them in connection with the enterprise, the first amount figuring purely as a retainer. The solidity given to the enterprise by the appearance of these responsible parties as its attorneys, was considered, and probably was worth the full amount paid them. Whether it was a strictly professional proceeding on the part of the attorneys is another question. It is presumable that they investigated the enterprise thoroughly and satisfied themselves of its real worth before entering into the arrangement.

CHAPTER XL.

LEGAL ASSISTANCE.

There are times in the financing of any enterprise of material value when legal assistance is desirable and perhaps essential. If a development contract is to be entered into, if a partnership is to be formed, if a corporation is to be organized, and particularly if promoters are to be dealt with, or if contracts are to be drawn up with moneyed men who are to finance or be otherwise interested in the enterprise, a lawyer should be employed.

This proposition requires but scant comment. It is a lawyer's business to understand, to advance and to safeguard the interests of his clients in matters of this kind, and just as a machinist is employed to construct a model, or a physician to treat some serious ailment, so should a lawyer be employed in the formalities connected with the financing of an enterprise. In the less important preliminaries, or when the whole matter is perhaps merely one of discussion, he may not be needed. When, however, the point of fixed agreement is approached, his services are very desirable. They may, of course, be dispensed with, but such "dispensation" is apt to be a reckless and extravagant proceeding.

The man who is not versed in the law and not

familiar with contracts cannot safely write one or pass upon one already written. He may understand the English language well, but will be totally unable to see the pitfalls concealed in the legal phraseology of a well-drawn contract. He may be able to write with accuracy and even elegance, but being unacquainted with the requirements of the law and not knowing the "danger points" of an agreement, he is as little qualified to draft a contract as he is to argue a case in court.

All through the procedure of financing the man unfamiliar with the law—if acting without an attorney—is working at a serious and even dangerous disadvantage. He will stumble into a partnership—as is frequently done without intent when the owner of the enterprise and the man with money join forces—without the least idea of the responsibilities assumed, the risks involved or the best arrangements to be made. If a corporation is to be organized he may perhaps be able to comply with the statutory formalities and may carry through the organization. If he does, it will be but lamely, and his corporation will also usually limp. Something of advantage will be omitted, something unnecessary or even injurious will be included, and not one time in a hundred will the corporate organization be so arranged as to secure all the available advantages and the best possible working mechanism. An unskilled man is groping in the dark and it would be strange if he should attain the best results.

Particularly, as has been said, should a lawyer be retained when negotiations are to be carried on with

promoters and moneyed men. As a rule these men are naturally acute and are experienced in the matters involved. They know exactly what advantages are to be gained and how to gain them. They are themselves usually assisted by or are in consultation with first-class lawyers, but even if they are not, the man with an enterprise should not be thereby lulled into fatuous security. The probabilities are that they are so familiar with the matters in hand, know so thoroughly every trick to be turned, and are so versed in the related requirements of law and business that no lawyer is needed to protect their interests. In all cases he may rest assured that lawyers are within easy reach should the need arise, and if the man with the enterprise is not similarly prepared he is hopelessly outclassed from the start. Then, if he finds that his contract means a little more or a little less than he supposed, or finds that the control has been taken from his hands without adequate provision for his protection, or finds that something else essential to his interests has been omitted, or that something injurious to his interests has been included, he has no one to blame but himself. He has gone as a sheep to the shearing, and if he returns more or less shorn it is but the happening of the expected.

The man with an enterprise will sometimes, however, not only omit to employ a lawyer of his own, but will actually leave the whole matter in the hands of the attorneys on the other side. At this time the relations between all the parties are, as a rule, pleasant, the lawyers employed by the people with whom he is negotiating are perhaps men to inspire confidence, and

the man with the enterprise feels that he is safe in their hands. In consequence he allows them to arrange the details and to draw the papers, merely checking up on the main points and trusting to their explanations of any matters he does not understand.

The folly of such a proceeding cannot be too strongly condemned. It has been said that a man who is his own lawyer has a fool for his client, but the term is not strong enough to describe the man who looks to the other man's lawyer for his own protection. It is but rarely, if ever, that the interests of the parties on the two sides of a deal are the same. Then, for the man with the enterprise to entrust his interests to an attorney retained by the opposing parties, is unwise, to say the least. No man can serve two masters and no matter how honorable an attorney may be, he can rarely represent the two parties to a transaction with entire justice to both. His first duty is to the man who employs him, and if either party is to be favored, his employer will undoubtedly and properly be the favored one.

For instance, if a contract is to be drawn up with a promoter, it may be so worded as to be an exclusive and perpetual one—that is, one that will tie the enterprise up indefinitely if the promoter does not succeed in his financing. Such a contract clause is much desired by the ordinary promoter. Certainly, then, the lawyer of that promoter should not and would not think of calling attention to this feature of the contract if the owner of the enterprise did not see it himself. If such a contract is executed, the enterprise is practically mortgaged to the promoter,

the owner will find much trouble in releasing it and usually before the enterprise can be financed by the owner, or anyone else, the promoter must first be paid his full commission, or perhaps some smaller amount agreed upon as a compromise.

Or again, the inventor may be entering into a contract for the operation of his patent. Here a number of important points must be covered. Perhaps in the particular instance, a satisfactory royalty may be provided, but no fixed minimum production. Such an omission is not infrequent in royalty contracts and is directly in the interests of the party with whom the inventor is contracting. Certainly the attorneys for this other party would not and could not properly call the omission to the inventor's attention. Then the unhappy inventor, not being familiar with the subject, is not himself apt to discover the damaging omission at all, or should he do so, does not usually realize its significance until too late. Then, when the contract is closed, if the manufacturer does not care to operate under the patent he cannot be forced to do so, the inventor receives no royalty, finds himself hopelessly tied up and has no recourse of any kind save to abuse himself for the reckless disregard of ordinary business precautions which has caused his trouble.

Or there may be local laws or conditions that will materially affect the contract, or the general arrangements entered into by the owner of the enterprise, but which this latter knows nothing about, and if he is depending on the other man's lawyer, is not likely to discover until too late for the proper protection of his own interests.

In short, the details connected with the financing of any enterprise of material value are so important and there are so many details, technical or otherwise, to be observed that to carry them through without the assistance of an attorney is a most dangerous waiver of the rules of safe business. As to those who not only fail to retain an attorney, but actually leave their interests in the hands of the parties on the other side and the attorneys of those parties, it can only be said that they deserve whatever hard fate befalls them. They are looking for trouble and will doubtless find it.

It is obvious of course that this necessity for legal assistance does not exist to the same degree, or at all when the matter is of small value or importance and the parties on both sides, even though unversed in the law, are not represented by lawyers. A man may with reasonable safety make a contract in minor matters with his friends or neighbors without going to the expense of a lawyer's fee. Here the contracting parties are in friendly relation, stand on an equal basis in their ignorance of the law and are presumably desirous of a contract fair to all parties. There is no "playing for points," and the whole matter is merely one of expressing the wishes of the parties in the plainest, simplest language possible.

When, however, the man with the enterprise is dealing with strangers, and in any case where the amounts involved are large, and particularly when attorneys are employed on the other side, the situation is entirely different and the remarks that have been made as to the importance of legal assistance apply with force.

While insisting on the importance of legal aid, the

author must admit that a poor lawyer is even worse than none, and that a competent attorney is apt to be costly and is often difficult to secure, especially for the stranger. Also, if all the profits of a transaction are to be paid to lawyers, they might as well be lost at once. How then is a stranger to tell the good from the bad, and how is he to guard against such excessive charges as will be either beyond his ability to pay, or outside the justifiable expenses of the particular case?

In the first place, any lawyer selected should be at least reliable and of reasonable ability. If the party desiring the services of an attorney has friends in the particular city, they can usually direct him to a lawyer who is honest and fairly capable. The party should himself be able to gain some idea of this attorney's ability by a preliminary discussion of the matter with him. A reputable attorney will not make any charge for a short conference of the kind, though, if there is any doubt on this point, the prospective client may properly set it at rest by a direct enquiry.

Speaking generally, it is not advisable for the man with an ordinary enterprise to retain either an inexperienced lawyer or one of much prominence. If the matter is at all complicated an inexperienced lawyer cannot properly protect the interests of his client. A prominent lawyer, on the other hand, may charge much more than the enterprise can afford to pay. In a matter of moderate importance the best results are often secured by the employment of a young lawyer who is not far enough along to charge excessive fees, but who has yet had sufficient experience to qualify

him for the work. He will, as a rule, take far more interest in the matter than would an older man, be more active in its behalf and be more moderate in his charges.

The legal fees in matters connected with the financing of an enterprise vary greatly with the work to be done and the values involved, ranging from \$25 or \$50 for the drafting of a simple contract in some ordinary enterprise, up to the enormous amounts paid in the larger flotations. If the client cannot afford a large fee, or the matter does not justify it, he will do well to determine and arrange in advance for the cost of the services desired. No reputable lawyer objects to an enquiry of this kind. In many cases, and whenever he can do so with safety and propriety, he will name a fixed price. Usually he can name a sum which his fees will not exceed, and always he can give some general idea of his charges.

If the client's means are limited it is always advisable for him to explain the situation fully to his attorney. In such case this latter will usually either agree to keep within some specified amount, or will frankly tell his client that he cannot do the work within the limits mentioned and will perhaps advise him what had best be done. Frequently and not improperly, attorneys will take all or a portion of their fees in the securities of the enterprise to be financed, or wait for payment until some future date. In either of these cases the attorney will properly expect a much larger fee, particularly if it consists of stock or some other interest in the enterprise which depends upon the success of the undertaking to give it a value, than if the payment were cash.

Unless some understanding is reached in advance, the client not familiar with lawyers' charges is apt to be very disagreeably surprised when his account is rendered. A demand for thousands may come in when the client is expecting hundreds, or a charge of hundreds be made when the client is expecting a modest fee of \$25 or \$50. Any unpleasant possibility of the kind may always be avoided by a preliminary discussion of the matter with the attorney.

The work of the lawyer does not end with the mere formal preparation of legal instruments. His functions extend far beyond this. He is, or should be, a good business man and will advise—and usually advise wisely—as to the merits and details of the arrangement to be entered into, will make practical suggestions, and, if desired, will conduct or assist in the negotiations. Furthermore, it is to be remembered that lawyers on occasion make very excellent promoters themselves.

On the other hand, it must be noted that there are members of the legal profession who regard clients as "their natural enemies"—this expression coming directly from an attorney who undoubtedly acts on this belief—to be preyed upon as may be possible, and to be protected from the outside world only to be preserved for the benefit of their attorneys. The law is not peculiar in this respect. All callings are afflicted with disreputable members, and the shyster lawyer is a feature, not a characteristic, of the legal profession. By enquiry, by a preliminary discussion and by a general sizing up of the particular lawyer, and by an advance discussion of fees, it should always be possible to avoid the clutches of unworthy members.

When a lawyer is secured the client should co-operate with him in every way. His attorney, even though a good one, can hardly comprehend the matter in all its bearings as well as does the client, or not being infallible, may possibly make a mistake or be guilty of an oversight, and the client should be at hand to assist, to check up, and to supplement as far as he can. It is a matter in which both are interested, but in which the client has most at stake.

CHAPTER XLI.

ADAPTATION OF CORPORATE FEATURES.

Almost any business arrangement desired is possible under the corporate form. A few instances will perhaps best illustrate the flexibility of the corporate system and the manner in which it may be used to further the financing and development of an enterprise.

Possibly an inventor may have devised a new mechanism. He wishes money to patent his invention and construct a model. He interests some friend who agrees to advance the few hundred dollars required for this work on condition that he be given a half interest in the invention. They must then either form a partnership or a corporation. A partnership is usually objectionable and they will probably decide upon a corporation.

As discussed in a preceding chapter (Chapter XVI), the amount of capitalization fixed upon for this corporation would usually be immaterial. To avoid the expense incident to a large capitalization, such as state fees, attorneys' fees, taxes, etc., the interested parties would probably fix on some small amount, say \$1,000, and the corporation is formed. The inventor assigns his invention to the corporation, agrees to assign his patents to it when secured, and receives stock to the face value of \$500. His friend undertakes to supply

the needed money up to whatever limit may have been agreed upon, and in return receives the other half of the capital stock.

The corporation is then composed of but two members or stockholders, each holding one-half the stock. If the law—as is the case in most states of the Union—requires three directors, some friend, relative or perhaps the wife of one of the parties is invited to act as the third director. The inventor and his associate are probably the only officers elected, most conveniently one as president and the other as secretary and treasurer. The little corporation is then distinctively a “close” corporation. It could be managed with as scant formality as a partnership, and would run along easily until the necessary patents were secured, a model constructed and the enterprise brought into shape for financing and development.

At this stage a larger corporation is desirable. Two courses are then open. The capital stock of the small corporation may be increased or an entirely new corporation be organized. Usually the new organization is preferred. Then the value of the invention and, based upon this, the best capitalization of the company—which before was a matter of indifference—becomes a question of much importance. The manner in which it would usually be determined is also discussed in a preceding chapter (Chapter XVII).

The inventor and his friend are probably willing to give a half interest in the enterprise for the money necessary for its development. This money might perhaps be estimated at \$25,000. Then the capitalization might be fixed at \$100,000, all presumably common

stock, of which they will offer \$50,000 face value for the needed money.

If they settle on this offer of \$50,000 of common stock for their money and wish to carry the matter through on this basis without change and without making concessions of any kind to the men with money, they would then organize the corporation—which would make changes of stock difficult, whether as to amount or character—and secure their money on the offered terms if they could. Unless, however, the whole arrangement has been made in advance, there might be much doubt as to whether the money could be raised on the exact plan proposed, and if so, the owners of the enterprise would not incorporate, but merely adopt the arrangement in a tentative way, so that it might be changed if necessary.

It is more than probable that the plan proposed would not suit the men with money. The offer of \$50,000 of common stock might not appeal to them. Possibly they would suggest that as they were putting in all the money it would only be fair that this money be secured in some way. Perhaps they would propose that of the \$50,000 of stock to be given them for the money, \$25,000 be made a six per cent. cumulative preferred stock, payable in case of liquidation of the company out of its assets before anything was received by the common stock.

Such a demand is not unreasonable. The preferred stock, it is true, would receive its six per cent. dividend out of profits before either the stock of the inventor and his friend or the common stock of the investors received anything, and would also have

preference in case of liquidation of the company. If, however, the owners of the enterprise felt sure of the merits and success of their invention they could hardly object to this. The enterprise, if successful, should not only pay dividends of six per cent. or more on all the stock, but accumulate assets in addition sufficient to redeem both the preferred and common stock at full face value on the termination of the company. The inventor and his friend would, therefore, probably accept the proposition.

Two questions might then come up,—first, whether the preferred stock should participate in dividends beyond its six per cent., and second, whether it should have the right to vote. The investors would probably, and not unreasonably, insist upon both these points. Whether they should be allowed would be purely a matter of business policy. Probably the inventor and his friend would yield in both matters, as the investors would not really have a full half interest in the entire enterprise unless their stock did have these two additional rights. If so, all the investors' stock, both common and preferred, would vote and their preferred stock—after it had received its six per cent. dividend and all the common stock of the company had received a like amount—would participate in any further dividends declared in that year, just as would the common stock. It is to be noted that unless expressly provided otherwise—usually in the charter of the company—the preferred stock would have these rights as a matter of course.

Frequently investors will make other and varying demands. They might agree to the general proposi-

tion of a half interest for the money, but would be almost certain to demand control of the company. If this point is conceded the question at once arises as to how the matter may best be arranged. The control usually rests with the majority of the stock, the parties owning or controlling such majority electing the board of directors, and through this board controlling the company. Either then the majority of the stock must be given the investors, or otherwise the usual voting power of the stock must be limited or modified in some way. The end desired may be attained by several different methods. The more important of these follow. The term inventor as used therein designates both the inventor and his friend.

(1) By giving fifty-one per cent. of the voting stock to the investors, the inventor retaining but forty-nine per cent. This is the plan most commonly followed. The investors would then have a little more than half the stock of the company and the inventor a little less.

(2) By an equal division of the stock, a portion of the stock issued to the inventor being deprived of the voting power. This is effective, but in some states is not legally permissible, the laws prohibiting the alienation of the voting right from common stock.

(3) By issuing a portion of the inventor's stock as non-voting preferred stock. The laws rarely if ever prohibit the issue of preferred stock without the voting right. Hence this plan may be carried out when common stock could not be issued without the voting right. In this case perhaps \$10,000 of the face value of the inventor's stock would be non-voting participating pre-

ferred stock and \$40,000 would be as before, common stock with the voting right.

(4) The stock might be divided equally between the two parties, but a board of directors be selected acceptable to the investors and to the inventor as well, and this management be maintained by means of a voting trust. This arrangement is effective and is discussed later.

(5) The stock might be divided equally between the two parties, but be so classified that the majority of the directors would be elected by the investors' stock. This plan is also very effective and is discussed later.

The voting trust plan already referred to is allowable in most states of the Union, and when employed in the way suggested may serve a double purpose. It insures the investors control of the company by giving them a majority of the board of directors and at the same time may be arranged to insure representation on this board to the inventor and his friend, or speaking generally, to the minority interests. Under this arrangement a board of directors would be agreed upon between the parties. At this stage of the proceeding all parties are usually friendly and a board acceptable to all of them could probably be agreed upon without trouble. If the board consists of five members the investors might select three of these directors and the inventor and his friend two, the control thereby being given the investors. When this is done the "agreed" board would be elected by unanimous vote of all the stock. Then, if the entire stock of the company or even a majority of it were placed

in a voting trust for a term of years under an agreement that its full vote be cast for the designated board of directors, that board would be elected and continued unflinchingly until the termination of the trust. Of course, provision must be made for deaths or resignations among the membership of the board. Such vacancies might be filled by unanimous vote of the remaining members of the board or by agreement between the inventor and the investors, or could be provided for in any other equitable way. The main point to be secured is the maintenance of the same, or an acceptable management for the term of the voting trust. The arrangement is effective and is sometimes very desirable. The actual stock held in such a voting trust is in the hands of trustees and cannot be sold or transferred in the usual way. To obviate this difficulty, negotiable trustees' receipts or certificates are usually issued to represent the "tied-up" stock, and these represent, and when sold, transfer the equitable ownership of the stock. At the termination of the voting trust the holders of these trustees' receipts exchange them for certificates of stock as called for by the receipts.

It is to be noted that an ordinary contract or agreement providing that stock shall be voted for certain persons or in a certain way, is not sanctioned by law and cannot be enforced in the courts, particularly when the stock has passed from the hands of the original holders. The voting trust, on the contrary, is allowable under the laws of most states and its conditions may be enforced by legal proceedings if necessary.

The control of the company by the investors, and

in addition minority representation on the board may be secured, if the laws permit, even more satisfactorily by a classification of the stock. Under this arrangement the stock may be divided equally between the two parties, \$50,000 to the investors and \$50,000 to the inventor and his friend. This stock is then classified, best by an insertion of a provision to that effect in the charter of the corporation at the time of organization. The \$50,000 of stock belonging to the inventor and his friend might be classed under some convenient designation, as "Class A," and be given the absolute right to elect a certain number of directors—two directors, perhaps, if the board consists of five members. The \$50,000 face value of stock belonging to the investors would be classed under some other designation, as "Class B," and this stock would also be given power to elect a certain number of directors—probably three if the board consisted of five members. Then both of the parties hold an equal amount of stock and share equally in the profits and property of the corporation, but at all elections the investors' stock elects three directors and the inventor's stock elects but two, thereby giving the control to the investors, but also giving due representation on the board to the inventor and his friend.

The general arrangement of classified stock is an exceedingly convenient and practical one, where permitted by the laws of the state, and may be varied to meet almost any desired conditions of management.

When the voting trust is employed or stock is classified, the inventor and his friend, or in other cases the minority interests, are insured representation on

the board. This representation is very important and is perhaps the most efficient possible means of protecting the interests of minority stockholders. This is so because of the very broad powers vested in the board of directors and the conditions which govern the board and its action.

The board of directors has absolute control of the affairs of the company and unless its action is absolutely illegal or grossly improper, cannot be interfered with by the stockholders. Under these circumstances, if the investors elected the entire membership of the board it is not at all impossible that its proceeding might be of the star chamber order and the company be managed in the interests of the investors rather than for the good of all, and this without any positively illegal action on the part of the board. It therefore becomes of the greatest importance for the minority interests, or in the present case the inventor and his friend, to have representation on the board, in order to know what is being done, to protest against improper action or to secure information of any illegal action, should such action be contemplated.

If the inventor and his friend elected one or more directors, the investors would still have the majority of the board, and would therefore still control its action. The inventor's representatives must, however, be notified of all board meetings and would have a right to be present, and they would therefore be able to act as a more or less efficient check upon improper majority action. The minority could not in any way prevent proper action of the majority, but if anything wrong was attempted the inventor and his friend,

through their representatives, would have immediate knowledge of the proposed action and could either protest against it or resort to legal proceedings to stop it if necessary. In practice the mere presence of minority representatives on the board tends strongly to prevent attempted action injurious to the interests of this minority.

As stated, if a voting trust is established or stock is classified, board representation for the minority may be effectually secured. If neither of these arrangements is adopted, some other provision to the same end is very desirable. The best and most efficient of these, and the one most commonly employed, is cumulative voting.

Under the ordinary system of voting, every share of stock may cast one vote for each director to be elected. That is, if five directors are to be elected, every share may cast one vote for each of five candidates, and this is the only way its full vote can be cast. Therefore the parties holding a majority of all the shares of a corporation can elect every member of the board of directors, and in the case under consideration, if the investors had \$50,000 face value of voting stock and the inventor and his friend had but \$40,000 face value, the vote of these latter would be absolutely unavailing. They could not elect a single director and would have no representation on the board.

The system of cumulative voting is allowed in almost every state of the Union. Under it each share of stock has one vote for each director to be elected as before, but the manner in which these votes are

to be cast is much less restricted. They may, if desired, be cast as in ordinary voting, one for each candidate up to the full number of directors to be elected, or may all be cast for a single candidate, or they may be divided among the candidates in any way desired. Under this arrangement the inventor and his friend, holding voting stock to the par value of \$40,000 or even to a much less amount, could, if they stood together, always elect one or more members of the board.

For instance, suppose the board is to consist of five members. Then each share of stock is entitled to five votes at elections of directors. If the inventor and his friend hold \$40,000 of voting stock, they would have 400 shares—shares being \$100 each—and therefore five times 400, or 2,000 votes, at their disposal. If the other parties had the remaining 600 shares they would cast 3,000 votes, and under the ordinary system of voting would infallibly elect the whole board. Under the cumulative system, however, the inventor and his friend being able to “cumulate” their votes as they saw fit, might put two candidates in nomination and divide their entire vote between these two, giving each 1,000 votes. There is then no possible way in which the other parties could so divide their 3,000 votes as to defeat the inventor’s candidates. They could give three candidates 1,000 votes each and elect these three, but they could do no more. If they divided their 3,000 votes equally among four candidates, each would receive 750 votes, or if among five, each would receive 600 votes, which in either case is less than the number received by the inventor’s can-

didates. As a matter of fact, the inventor and his associate would be absolutely sure of electing their two candidates—who would probably and properly be themselves—so long as they acted together.

Occasionally the proposition of the inventor to give \$50,000 of stock for \$25,000 in cash will be met with a counter proposition from the investors stipulating that this full amount of stock be issued as preferred stock with the voting right. If this preferred stock is limited to its six per cent. preferred dividend, the arrangement would be a very good one for the inventor and his friend, as all profits earned above the six per cent. paid the preferred stock would then belong to them. Probably, however, the men with money would demand that the preferred stock participate fully in further dividends. This demand would still not be severe. If the invention is good, profits should be earned that will pay far more than the six per cent. dividend on the preferred stock, and in such event the mere fact that the preferred stock is entitled to the first "helping" would be a matter of entire indifference. If the invention is not good enough to do this, the inventor and his friend ought to be even more willing to allow the investors the advantage of the preference, as the failure is then on the inventor's side.

Sometimes, however, the investors will propose that they receive preferred stock to the amount of \$50,000 for their money, and in addition to this receive a bonus of an equal amount of common stock. Usually in such case the investors' offer would contemplate a non-participating, non-voting preferred stock, but even

then, unless the conditions of the enterprise are desperate, the inventor had better refuse the proposition. It is unreasonable and excessive. If accepted it would necessitate a capitalization of \$150,000 if the inventor and his friend are to have their \$50,000 of common stock. The arrangement would then mean that the investors, in case the enterprise is successful, receive an annual interest of twelve per cent. on the \$25,000 of cash actually invested by them as long as the preferred stock is outstanding, and that whenever it is retired they receive back twice the amount of money actually put in, while in addition to all this, they participate equally in any further profits or property of the enterprise on exactly the same terms as the inventor and his friend. Obviously the conditions are harsh.

If the parties putting in the money should demand a non-voting, non-participating preferred stock, or perhaps bonds to the amount of \$25,000, to represent and secure the actual money they invest, and in addition \$50,000 of common stock as a bonus, the inventor retaining an equal amount of common stock, the terms are again severe, but perhaps not so much so as to justify a refusal. Then the whole transaction is practically a loan of the money to the enterprise, secured by the preferred stock or bonds. On this loan the investors receive dividends or interest and finally receive their money back. Their common stock represents a bonus for making the loan, and if the enterprise is a fairly good one, is excessive. Possibly the investors would agree to a smaller proportion of common stock, though, unless some arrangement were

made to give them the control, this is not probable, as they would wish a sufficient amount of voting stock to fully protect their interests.

It is to be noted that in any arrangement of this kind—which may be modified in many ways—an issue of preferred stock is much preferable to a bond issue. If the dividends are passed on preferred stock—even though cumulative—payment cannot be forced to the injury of the company, but the deferred dividends merely pass over until such time as there are profits from which they may be paid. The interest on bonds, on the contrary, is an absolute fixed charge which must be paid when due under penalty of foreclosure of the bonds. That is, the preferred stock receives its dividends if profits are made; the bonds must receive their interest without regard to the financial condition of the company. The bonds may possibly endanger the very existence of the enterprise. Preferred stock cannot. For this reason, bonds are to be avoided as far as possible in a new and unproved enterprise.

Possibly when the time came to finance the enterprise we are now considering, the inventor's original friend might be so favorably impressed with the invention that instead of allowing the appeal for money to be made to outsiders he will himself put in the \$25,000 of cash required. Then an entirely new set of conditions arise. Should he be given \$50,000 of voting stock for his money, and also receive his half of the reserved stock, amounting to \$25,000, he would then own \$75,000 of the stock, or three-fourths of the whole company, and would control it absolutely.

Such a condition would probably be objectionable

to the inventor. He might be willing for his friend to be equal to him in the management or perhaps even consent to his control, but would not relish such a preponderance. The emergency might be met by an issue of non-voting stock for the money. This stock would probably be a preferred stock and would usually be limited strictly to its preferential dividend of six per cent., or such other per cent. as might have been agreed upon. Then the friend, now the investor, would receive annual dividends of six per cent. on his \$50,000 of preferred stock—which is equivalent to twelve per cent. on the \$25,000 actually invested—before the inventor received anything. Then he and the inventor would participate on an even footing in the remaining profits. Both would be equal in voting power and therefore the equality of management would be maintained.

Possibly, however, the inventor's friend would insist on receiving the full \$50,000 of common stock of the investment—which would, if the enterprise proves good, be a very much better arrangement for him—and if the inventor had already agreed to grant these terms to strangers, he could hardly refuse his friend. At the same time he might very properly demand equal power in the management. The matter might then be arranged, as already discussed, by means of the voting trust or perhaps better by a classification of the stock.

If the board is composed of an odd number, such as three, seven or thirteen, as is usually the case, each class of stock might be given the power to elect an equal number of directors, leaving the one odd mem-

ber to be elected in some other way. For instance, if the board were composed of five members and there were two classes of stock, each class might be given power to elect two directors. This would provide for four of the directors, and the election of the remaining director might perhaps be effected by agreement between the two groups. Should a tie result, the fifth director would fail of election and then, as the board of directors is usually empowered to fill vacancies, the matter would probably be left to the board itself. Presumably the four members would be able to agree on some fifth member. If not, the board must act with four members instead of five. If, however, the fifth director were once elected and the by-laws provided, as is usually the case, that a director once elected holds his office until the election of his successor, the fifth director would, in case of a tie at any subsequent election, hold over and the board would then be complete, though but four new members were elected.

It is sometimes necessary in making the corporate arrangements and adjustments to issue bonds with some special rights. A bond issue will occasionally be made participating—that is, profit-sharing. In this case the bonds first receive their regular interest and then in addition receive dividends from profits. The arrangement is not common, but where it does exist usually provides that the bonds after receiving their annual interest, shall then participate on the same basis as does the stock of the company in any dividends declared. It would seem to be more equitable that the stock should receive a dividend equal to the interest of

the bonds before these latter begin their participation in profits.

Another provision not uncommon and intended to provide some additional protection to preferred stock, is an arrangement that in case preferred dividends are not paid for a certain period, or if they fall in arrears to some specified amount, then such preferred stock shall have the right to vote. Usually in such cases this voting right, when effective, places the control of the company in the hands of the preferred stockholders. Or sometimes it is provided without reference to voting rights that the control of the company shall pass to the preferred stockholders in case of failure of dividends for a specified period or to a prescribed amount. The arrangement is a very fair one. If the common stock in which the management rests cannot direct the company successfully, it is but fair that it should step aside and give the preferred stock an opportunity to not only protect its own interests but benefit the common stock as well by a better administration.

Very occasionally it will be provided that preferred stock after payment of its dividend, shall receive a certain proportion of all profits each year until its face value has been paid in full. The stock is then cancelled and is practically non-existent. Usually when such an arrangement is made preferred stock is issued to the full amount of the money invested and in addition a bonus of common stock is given to the investors. In this case the investors receive back their money from the profits of the enterprise and then—all parties being “on velvet”—participate equally, or in accordance with their stock holdings, with the owners of the enterprise in any further profits.

Practically this same arrangement is at times carried out by the money being advanced as a loan, to be repaid as agreed, and the party making the loan receiving a substantial bonus of stock for the "accommodation." When this plan is adopted, care should be exercised that the laws against usury are not violated.

In all the various modifications of the corporate arrangements discussed, it must be borne in mind that any stock not full paid—either technically or actually—subjects the party to whom it is issued to a liability for the unpaid balance as long as he holds such stock. This unpaid amount may be claimed by the corporation—unless barred by an express waiver of such claim—or by any creditor of the corporation. Usually this liability does not follow the stock into other hands but is extinguished when the original owner parts with the stock.

The full payment of stock demands more care than is usually exercised. If any colorable *quid pro quo* is given in exchange when stock is issued, such as an invention, a mine, a business or other property of real present or prospective value turned into the corporation, the courts will usually hold the stock to be full paid. In many cases, however, the property exchanged in order to make the stock full paid is so utterly inadequate that the transaction will not stand the scrutiny of the courts. Under such circumstances, should the company become insolvent, the creditors might collect the entire amount needed to make this stock actually full-paid, provided only that the stock is still in the hands of the parties to whom it was first

issued, or if in the hands of others, that the certificates are not marked "full-paid."

It is but seldom this point arises, but it may be so serious when it does that parties receiving stock direct from the issuing corporation should be quite sure that it has been fully paid before taking it in their own names. If their stock is purchased from other parties and the certificates are marked full-paid, they may take the stock with full confidence, for no liability could then follow it, no matter what price was paid either by the original or by the present purchasers. If, however, their stock is purchased at less than its par value and comes direct from the company, or the certificates are not marked full-paid, its condition requires investigation. Otherwise there is always a possibility of unexpected and unwelcome liabilities arising later.

APPENDIX.

CHAPTER XLII

THE INVESTOR'S QUESTIONS.

The following questions were originally prepared to assist in the investigation of enterprises from the standpoint of the investor. They cover broadly the important points upon which the investor must have information, or should have information if he is to judge intelligently of an offering. As these same points must be considered with equal care by the parties who make the offering, the questions are given here for use in the preparation of prospectuses and in the make-up of the general presentation.

Many of these requirements of the investor have already been considered in the present work, but the condensed presentation which follows supplies the matter in a more accessible and more available form for the present use than that of the text.

These questions are comprehensive. They are supposed to cover broadly all those points in any incorporated enterprise upon which the investor has a right to be informed. In any particular enterprise it is probable that they will be but partially applicable. Some will be obvious and some unnecessary. In any case, however, when drawing up a prospectus or in preparing the facts for a general presentation, the questions may be used to advantage. Those that are

not available may be ignored. Those that do apply will be considered and the information they call for will be given in full or in part, or omitted entirely as may seem best to those in charge. If the information required by these questions, as far as they may apply, is incorporated in a presentation, together with any features peculiar to the particular enterprise, it can hardly be doubted that the presentation will at least be reasonably complete.

I. NATURE OF ENTERPRISE.

1. Is the basis of the enterprise sound?
2. Is the business or undertaking profitable elsewhere?
3. What competition or opposition will be met?
4. What peculiar advantages does it enjoy over these others?
5. Can it be conducted profitably under existing conditions?

II. PLAN OF ORGANIZATION.

1. In what state organized?
2. What is the capitalization?
3. Is the capitalization reasonable?
4. Has the stock been issued in whole or in part and if so, for what?
5. Is the stock offered for sale full-paid and non-assessable?
6. Has any of the stock preferences?
7. Is any stock unissued or held in the treasury?
8. Who has stock control?

9. Are the rights of smaller stockholders protected?
10. Are there any unusual features in charter or by-laws?

III. PRESENT CONDITION OF ENTERPRISE.

As to Property.

1. What properties or rights are controlled?
2. What is their value and how estimated?
3. Are these properties or rights owned, or held under lease, license, grant, option or otherwise?
4. If owned, are titles perfect?
5. Are there any incumbrances on the properties or rights?
6. If not owned, are the holding papers in due form?
7. If not owned, are the terms of holding reasonable, satisfactory and safe?
8. In event of liquidation, what would be worth of property?

As to Operation.

1. What operations have been or are now carried on?
2. What have been the results?
3. What difficulties if any have been encountered?
4. What is demand for the product or operation of the enterprise?
5. What is present status of the enterprise?
6. Are proper books kept?

As to Finance.

1. What are the present assets and their actual value?
2. What debts, claims, fees, rents, royalties or other payments or obligations are now due or are to be met and carried?
3. From what resources are these to be met?
4. Who handles the moneys and under what safeguards?
5. What are or will be the running expenses, salaries, etc.?

IV. MANAGEMENT.

Directors.

1. How many members in the board?
2. Who are these members?
3. What is their past record and present business status?
4. Who are the active members of the board?
5. Who if any are inactive?
6. Are meetings regularly held and attended?
7. Who compose the executive committee—if any—and what are its powers?
8. Are the directors stockholders, and, if so, to a material amount?

Officers.

1. Who are the officers?
2. What are their previous records?

3. What are their special present qualifications?
4. Are they able to work together without friction?
5. What compensation do they receive or are they to receive?
6. Are they interested in the enterprise beyond their salaries?

V. PLAN OF OPERATION.

1. What is the general plan of operation?
2. What special reasons if any led to its adoption?

VI. DISPOSITION OF MONEY ASKED FOR.

1. Does the money from sale of stock go into the treasury of the company?
2. If any does not go into the treasury, to whom does it go and for what purpose?
3. Of money going into the treasury, what proportion goes into active development and operation?
4. What part goes to pay off existing debts, obligations and claims?
5. What part, if any, goes to pay for promotion expenses, commissions, etc.?
6. How is the development and operating money to be applied?
7. Is the amount asked for sufficient to accomplish the desired results?
8. Will it place the company on a self-supporting or profitable basis?

VII. THE PROPOSITION.

1. Is the general proposition a fair one?
2. Is the price of stock or bonds reasonable?
3. How do these prices compare with any former prices?
4. If common stock is offered, do preferred stock, bonds or other profit-sharing obligations take precedence and to what amount?
5. What reserve of profits will be retained before dividends are to be declared?
6. If preferred stock is offered, is it cumulative, does it vote, when is it redeemable and at what price, what sinking fund provision is made for redemption and are any peculiar provisions attached? Do any bonds or other obligations take precedence of the preferred stock?
7. If bonds are offered, what interest is paid, and when and where; upon what property are they secured and when and how are they paid; is the trustee or trust company of repute; under what conditions are the bonds foreclosable; when and how are they or may they be redeemed; are there any other securities taking precedence, and are there any peculiar provisions in deed of trust?

VIII. GENERAL.

1. What is the previous history of the enterprise or the property or undertaking on which it is based?

2. If inventions enter prominently, what is the previous record of the inventor?
3. By whom are the statements made and is the party making them reliable?
4. Are there any contracts or obligations not now effective by which the enterprise will subsequently be affected?

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